
# Review of Financial Regulation in the Crown Dependencies

*Presented to Parliament by the Secretary of State for the Home Department*
*by Command of Her Majesty*
*November 1998*

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Part I

Principle Issues
Summary and Main Conclusions
Main Report

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## Part II The Jersey Finance Centre

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## Part III The Guernsey Finance Centre

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# Review of Financial Regulation in the Crown Dependencies

## Part IV The Isle of Man Finance Centre

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# OFFICE OF THE REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES

c/o Home Office
50 Queen Anne's Gate
London SW1H 9AT

Rt Hon Jack Straw MP
Home Secretary
Home Office
50 Queen Anne's Gate
London SW1H 9AT

24 October 1998

Dear Home Secretary

REPORT OF THE REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES

You commissioned me on 20 January 1998 to review with the Island authorities in Jersey, Guernsey and the Isle of Man their laws, systems and practices for regulation of their international finance centres, the combating of financial crime and co-operation with other jurisdictions.

I have pleasure in submitting my Report with this letter.

As explained in Chapter 1, the Report consists of four Parts.

Part I presents my own assessment. I take responsibility for what it says. It includes a two-page summary of Principal Issues followed by a full Summary and Main Conclusions and then the Main Report. A detailed list of contents is at the end.

Parts II, III and IV, prepared by the Island authorities in consultation with me, are professional guides to the finance centres of the three Islands.

In submitting the Report, I would like to say how much I appreciate the constructive way in which the Island authorities have co-operated in the Review and the immense amount of work they have put into it.

As explained in Chapter 1, many others, too, have made invaluable contributions.

I thank them all.

Yours sincerely,

Andrew Edwards

# Contents

# Contents

4.4 Collection of Income Tax
4.5 Taxation of Non-Residents
4.6 Particular Vehicles
4.7 Indirect Taxes
4.8 Other Taxation

5 FINANCIAL REGULATION POLICIES AND STRUCTURES
5.1 Government Policy and Responsibility
5.2 Related Jurisdictions/Comparison with UK Regulation
5.3 Regulatory Authorities
5.4 Broad approach to regulation
5.5 International bodies and conventions
5.6 Memorandums of understanding

6 BANKING BUSINESS
6.1 Policy
6.2 Legislation
6.3 Resources
6.4 Conformity with Basle 25 principles
6.5 Basle preconditions
6.6 Licensing and structurepolicies
6.7 Relations with home country supervisors
6.8 Regulation of subsidiaries and branches
6.9 "Managed" banks
6.10 Capital adequacy
6.11 Lending policies
6.12 Cash flow analysis/matching of assets and liabilities
6.13 Comprehensive risk assessments
6.14 Supervisory methods
6.15 Management quality
6.16 Off-site and on-site supervision, including employment of outsiders
6.17 Internal management and control systems, including segregation of duties
6.18 Information systems
6.19 Non-banking activities
6.20 Anti-fraud
6.21 Regulators ability to intervene
6.22 Enforcement
6.23 Oversight of Bureaux de Change

7 INVESTMENT AND SECURITIES BUSINESS
7.1 Policy
7.2 Legislation
7.3 Resources
7.4 Enforcement

7.5 Investment business servicesInvestment Business (Jersey) Law
7.6 Authorisation and authorisation criteria and processInvestment Business (Jersey) Law
7.7 On-going regulation and regulators ability to interveneInvestment Business (Jersey) Law
7.8 Collective Investment Schemes, open-ended
7.9 Collective investment schemesclosed-ended sector
7.10 Debt issuing structures
7.11 Regulation of stock exchange

8 INSURANCE AND PENSIONS BUSINESS
8.1 Policy
8.2 Legislation
8.3 Resources
8.4 Enforcement
8.5 Life assurance
8.6 Captives
8.7 Pension funds
8.8 Other
8.9 Authorisation/licensing criteria and procedures
8.10 On-going regulatory requirements
8.11 Solvency margin/reserve requirements
8.12 Permitted asset holdings
8.13 Submission of annual accounts and auditing
8.14 Public disclosure requirements
8.15 Separation of assets and liabilities for life business
8.16 Requirements for actuarial valuations
8.17 Regulators power to intervene
8.18 Frequency of liquidator or rehabilitator appointments
8.19 Policy holder protection
8.20 Passporting
8.21 Designation

9 REGULATION OF COMPANIES AND DIRECTORS
9.1 Company legislation
9.2 Types of company
9.3 Responsibility for licencing and regulation
9.4 Jersey incorporated companies
9.5 Non-Jersey companies
9.6 Locally administered companies registered elsewhere
9.7 Directors

10 PARTNERSHIPS
10.1 Policy
10.2 Types of partnership
10.3 Limited partnerships

# Contents

5 FINANCIAL SUPERVISION/REGULATION POLICIES AND STRUCTURES

5.1 Government policy and responsibilities

5.2 Supervisory/regulatory style and related jurisdictions

5.3 Legislation and terms of reference

5.4 Independence and accountability; Links with Government and Parliament

5.5 "Board" structure and operation

5.6 Finance Training Agency

5.7 Who decides individual cases and licences?

5.8 Documentation and filing

5.9 Financing

5.10 General supervisory/regulatory policy

6 BANKING BUSINESS

6.1 Policy

6.2 Legislation

6.3 Resources

6.4 Conformity with Basle Committee 25 core principles

6.5 Basle Concordat - capital adequacy

6.6 Licensing and structure policies

6.7 Relations with home country supervisors, international bodies and conventions

6.8 Supervision of subsidiaries and branches, including lending

6.9 Liquidity

6.10 Administered banks with no stand-alone presence

6.11 Comprehensive risk assessments

6.12 Management quality

6.13 Off-site and on-site supervision

6.14 Internal management and control systems

6.15 Information systems

6.16 Non-banking activities

6.17 Anti-fraud

6.18 Supervisors ability to intervene

6.19 Enforcement

6.20 Depositor protection scheme

6.21 Oversight of bureaux de change

7 INVESTMENT AND SECURITIES BUSINESS

7.1 Policy/comparison with United Kingdom

7.2 Legislation

7.3 Resources

7.4 Enforcement

7.5 Links with United Kingdom and other overseas regulators; exchanges of information; membership of international bodies

7.6 Investment business services

7.7 Licensing and licensing criteria/processes
7.8 Investment business services - on-going regulation and ability to intervene
7.9 Open-ended collective investment schemes
7.10 Authorisation process
7.11 Valuation and pricing
7.12 Investment policies
7.13 Reporting and disclosure requirements
7.14 On-going regulation and ability to intervene
7.15 Fund managers/trustees/custodians - licensing procedure, criteria, separation
7.16 Closed-ended funds
7.17 Authorisation criteria and procedures
7.18 On-going regulation and regulators ability to intervene
7.19 Stock Exchange

8 INSURANCE AND PENSIONS BUSINESS
8.1 Policy
8.2 Main legislation affecting the insurance sector
8.3 Resources
8.4 Enforcement
8.5 Authorisation and registration requirements
8.6 Authorisation and registration criteria and procedures
8.7 General representative
8.8 On-going supervisors requirements pro-active and reactive
8.9 Solvency margin requirements including valuation basis
8.10 The risk-based approach to supervision
8.11 Valuation of assets and liabilities
8.12 Permitted asset holdings
8.13 Approved assets
8.14 Submission of annual accounts and auditing
8.15 Duties of external auditors
8.16 Public disclosure requirements
8.17 Separation of assets and liabilities for life business
8.18 Requirements for actuarial investigations
8.19 Supervisors powers to intervene
8.20 Frequency of liquidator or rehabilitation appointments
8.21 Links with United Kingdom regulators, exchanges of information, International bodies and conventions
8.22 Accreditation and reviews
8.23 Policyholder protection
8.24 Passporting

9 COMPANIES AND DIRECTORS
9.1 Types of companies
9.2 Registered/incorporated companies - responsibility for "licensing and regulation"
9.3 Shelf companies

# Contents

4.1 Policies
4.2 Indirect Taxes
4.3 Direct Taxes
Individuals
Companies
(a) Resident Companies
(b) Non-Resident companies
(c) Tax exempt companies
(d) Tax exempt insurance companies
(e) International companies
(f) Limited Liability companies
Partnerships
(a) General
(b) Limited Partnerships
(c) International Limited Partnerships
Trusts

5 FINANCIAL REGULATION, POLICIES AND STRUCTURES
5.1 Policy
5.2 Development of Regulation
5.3 Agencies involved in the regulation and supervision of finance industry
(a) The Financial Supervision Commission
(b) The Insurance and Pensions Authority
(c) Other Agencies
5.4 Regulatory Legislation and Supervision
(a) Financial Supervision Commission
(b) Insurance and Pensions Authority
5.5 Investor Protection
(a) Banks/Building Societies
(b) Collective Investment Schemes
(c) Insurance Companies

6 BANKING BUSINESS
6.1 Policy
6.2 Coverage
6.3 Domestic licences
6.4 Offshore licences
6.5 Licensing and supervision
6.6 Combatting abuses
6.7 Legislation

7 INVESTMENT AND SECURITIES BUSINESS
7.1 Investment Businesses
7.2 Collective Investment Schemes

# PRINCIPAL ISSUES FROM THE REPORT

*General (Chapters 1-5)*

- The Crown Dependencies have been very successful. They are clearly in the top division of offshore finance centres.
- The legal frameworks, judicial and prosecution systems, regulation, policing and co-operation with other jurisdictions mostly work well. Conflicts of interest are generally well-handled.

*Financial services regulation (Chapters 6-9)*

- The regulatory bodies, all now independent of Government, are good. Their Boards should prefer-ably not include politicians.
- Prudential regulation of banks, investment business and insurance is generally of a high standard. There are points for consideration on the individual regimes.
- Regulation needs to be deepened, in the Islands as elsewhere, so as more fully to cover management and control systems, staff quality, risk management, conduct of business, and countering of client abuses.
- In Jersey and Guernsey, there is scope for strengthening enforcement and the policing of unlicensed business through dedicated enforcement units.
- Co-operation with overseas regulators is good, though recent Jersey legislation could restrict it in ways not intended.
- There is a case for introducing financial services ombudsmen (or a common ombudsman) and, as already in the Isle of Man, customer protection schemes.

*Companies, Trusts and service providers (Chapters 10-13)*

- Jersey and Guernsey have good systems for vetting company incorporations. But in all the Islands the regulation of companies needs to be strengthened.
- The Isle of Man should consider vetting companies at registration and requiring confidential disclosure of beneficial ownership. The locally incorporated non-resident company category should preferably be abolished.
- All the Islands should extend registration and regulation to the many companies administered in the Islands but incorporated elsewhere.
- Some disclosure of financial information, even on a confidential basis, should be considered pending wider agreement, offshore and onshore, about disclosure regimes.
- The Isle of Man and Guernsey plan to update their insolvency procedures and introduce an office of Official Receiver. Jersey has done so already. All the Islands plan to introduce modern rescue procedures or are considering them.

- The Islands have good legal frameworks for Trusts. As elsewhere, there is a case for further legislation to counter potential abuses by settlors and trustees and to ensure proper accountability of trustees through enhanced disclosure and accounting requirements.

- A lead-Department in the UK, with responsibility for overseeing the UK's Trust sector, could promote an inter-Governmental forum of Trust jurisdictions in which the Islands could participate.

- The Report strongly commends the Islands' proposals to license and regulate providers of Trust and Company services. Such regulation needs, as the Island authorities envisage, to combat "nominee" Director abuses and abuses by clients as well as to protect clients. Enforceable codes of conduct are needed for Directors, company administrators and agents, and trustees. Providers of questionable competence or integrity should be weeded out.

- The professional regulation of lawyers and accountants in the Islands, already well developed, should extend to all practitioners and should cover provenance as well as handling of client accounts.

*Policing the finance centres (Chapters 14-16)*

- The Islands are firmly committed to combat crime of all kinds, including tax evasion and money laundering, and to the fullest co-operation with other jurisdictions. They have given exemplary assistance in many cases of drug trafficking, fraud, tax offences and money laundering.

- The Jersey and Guernsey authorities are committed to completing their legislative arsenals for combating crime by autumn 1999. The Isle of Man's is substantially complete.

- The Jersey authorities, in a welcome policy change, are now willing to assist overseas authorities investigating fiscal offences and smaller fraud cases.

- Where problems of co-operation have arisen in the past, they have mostly been at the investigation stage. The completion of the legislative arsenals and recent policy changes should dispose of these problems.

- The suspicious transaction reporting system seems to be working well in banks and insurance companies. Improvements should be sought elsewhere.

- Procedures for co-operation over the provision of evidence and restraint and confiscation of assets have generally worked well.

- The Report sketches four possible reforms of the present legislative arsenals and three possible reforms to take the profits out of crime. In all cases the UK would need to take the lead.

- There is a case for setting up self-standing, separately financed Financial Crime Units responsible for policing the finance centres.

*International (Chapter 17)*

- A new Offshore Steering Group, a new joint forum with onshore jurisdictions, and an extension of favourable treatment by the large countries of co-operative small jurisdictions, could all help to promote higher standards generally offshore.

*Resources and timetable (Chapter 18)*

- The Islands are firmly committed to deploy the resources needed to regulate and police their finance sectors effectively. The Law officers, police and regulatory authorities in each Island appear between them to need about 20 extra professional staff.

- The Report expresses the hope that by spring 2000 the Islands will have implemented, or be well on the way to implementing, all the proposals discussed or will have decided what alternative courses to pursue.

# REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES

## PART I

**by Andrew Edwards**

## SUMMARY AND MAIN CONCLUSIONS

*1 Introduction*

S1 The Home Secretary commissioned me in January 1998 to review with the Island authorities in Jersey, Guernsey and the Isle of Man the regulation of their international finance centres, the combating of financial crime and co-operation with other Jurisdictions. The accompanying Report presents the outcome of the review. (1.1)

S2 Part I presents my assessment. This reflects extensive discussion with the authorities and others in the Islands, in London and in other financial centres. It also draws on professional advice from Professor David Hayton, Mr Guy Sears, Mr Munro Sutherland and a former insurance supervisor. To all of these I am most grateful. (1.3-1.4)

S3 The sections of this Summary correspond to the Part I Chapters. The cross-references at the end of each paragraph are to the relevant sections or paragraphs of the Part 1 Chapters.

S4 Parts II, III and IV of the Report, prepared by the Island authorities in consultation with me, are professional guides to the international finance centres of each Island. **I hope that the Island authorities will keep these up to date and make them available on the Internet. I hope, too, that other offshore centres may be willing to prepare, and make available, similar guides.** (1.2)

*2 The Islands' finance centres*

S5 The Islands have been very successful in recent decades in developing their international financial centres. Their businesses include banking, investment, insurance, company and Trust business. The assets and liabilities of Island institutions and Trusts probably now amount to some 300 to 350 billion. Customers are now truly international. Large sums are channelled from the rest of the world through the Islands to the UK. (2.1-2.6)

S6 The Islands' success has depended importantly on internal self-government. This has enabled them, like other offshore centres, to offer customers tax and other advantages that the large centres are mostly either unable or unwilling to emulate. (2.7)

S7 Compared with other offshore centres, they have developed reputations for stability, integrity, professionalism, competence and good regulation. Their links with the UK and Europe have encouraged others to see them as "Offshore UK" or "Offshore Europe". (2.7)

S8 The finance industries have brought increased prosperity to the Islands. In Jersey and Guernsey, GDP per head is now well above that in the UK. The Islands' economies depend heavily on them. (2.8-2.11)

S9 Offshore centres generally are sometimes criticised for maintaining tax regimes that divert business from onshore

jurisdictions and deprive them of tax revenues. These issues lie outside the scope of the Report. (2.14)

S10 The critics also sometimes object to secrecy, poor regulation and poor co-operation in offshore centres. Such criticisms, if applied to the Crown Dependencies, would generally in my opinion be quite wide of the mark. For the most part, the position in the Islands is quite the opposite of what such criticisms would imply. (2.14)

*3 The Islands' reputations*

S11 I have no doubt that the Islands are in the top division of offshore centres. Many of the professional people I consulted commended their standards of regulation, the absence of corruption, and their co-operation with other Jurisdictions, especially in the pursuit of drug-trafficking. (3.1)

S12 Some raised concerns as well. So too did some of the Islands' people and customers who wrote to me, in response to my general invitation, about the Review. (3.2)

S13 The concerns most frequently mentioned, in relation to one or more of the Islands, related to conflicts of interest, customer disputes, and the activities of certain companies, company Directors and professional firms in the Islands. There were fears that Island activities were facilitating tax evasion and other forms of financial crime. Officials outside the Islands, while mostly complimentary, felt that the authorities could sometimes have co-operated better in the pursuit of crime. (3.2)

S14 Similar concerns would, I suspect, have been expressed about any other finance centre. But I have considered them carefully. The Report's conclusions take account of them. (3.2)

*4 Objectives*

S15 The Islands have a firm and continuing objective to be the best governed, best regulated and most responsible of offshore centres as well as the most successful. (4.1)

S16 **It is clearly in the best interests of the Islands, the UK and the international community that the Islands should set, and deliver, high standards in this way.** (4.1)

*5 Some aspects of government*

S17 The Islands score highly on *political stability*. For many centuries, they have been dependencies of the British Crown, without ever being part of the UK. Their political systems have been maintained and developed over many centuries. (5.2)

S18 When the UK joined the European Union in 1973, the Islands decided to remain outside. They prosper by being similar but different. (5.3)

S19 In Jersey and Guernsey, the *legislature and the executive* are closely intertwined. **In my opinion, this has not been a problem for the international finance centres.** (5.2)

S20 The Islands have impressive arsenals of *financial, company and criminal legislation*, mostly similar to, but not identical with, UK statute law. The common law systems resemble English common law, precedents from which are considered persuasive. (5.5-5.6)

S21 **The Islands' judicial and prosecution systems have shown themselves well able to deal with international finance centre business.** In all the Islands, the First Court of Appeal consists of or includes QCs or a QC from the UK. The final Court of Appeal is the Judicial Committee of the Privy Council in London. (5.7)

S22 In Jersey and Guernsey, the Chief Justices serve as Speakers of the Parliaments and as first citizens and spokesmen for the Islands. Some correspondents argued for separating these roles so as to put beyond doubt, in the perception as well as the reality, the i*ndependence of the judiciary from the legislature*. This lies beyond the scope of the Report. (5.7)

S23 Others argued that judicial review remedies should be available in Guernsey and Alderney, as in the other Islands. This too lies beyond the scope of the Report. (5.7)

S24 The Attorney Generals act as *public prosecutors* and as legal advisers to the Crown and the Island's Parliaments. They oversee or advise on law drafting as well. **The Islands need to ensure that they have enough resources for these tasks.** (5.8-5.9)

S25 The Islands have well-developed rules, publicly available, for combating *corruption and conflicts of interest* (a serious problem in many offshore centres). Local critics are indefatigable in attacking anyone thought to have committed such abuses. **Chapter 5 suggests some elements that the rules for Members of Parliament and Public Bodies should preferably include where they do not do so already.** (5.10)

*6 Financial regulation: objectives, structures and policies*

S26 **All the Island Parliaments have accepted that high standards of regulation are both obligatory and in the Islands' own best interests.** Their *broad approach* has been, rightly in my view, to follow UK styles of regulation, with adjustments for particular needs and risks of centres serving mainly non-resident customers; and to comply wherever appropriate with international and EU standards. (6.1)

S27 The Island Parliaments set the overall policy and legislative framework for financial regulation. But they have established *independent Financial Services or Supervision Commissions* (FSCs) to advise on and implement the regulatory regimes. (6.1)

S28 The Isle of Man's FSC dates from 1983. The regulation of insurance was transferred in 1986 to a separate Authority later made responsible for supervision of pension schemes as well. The Guernsey FSC dates from 1988. In Jersey, the Parliament's Finance and Economics Committee acted until this year as Regulator. But Jersey, too, now has an independent FSC. (6.2)

S29 **In my opinion, the Islands are right to have independent regulatory authorities. There are strong arguments, especially in small jurisdictions, for having one authority rather than two or more. This authority should preferably be responsible for company registration and regulation as well.** (6.3)

S30 In all the Islands, the Parliaments approve appointments to the *Boards* of the regulatory authorities and can give them written directions of a general nature. In the last resort, they can remove the Boards. **The statutes should preferably specify, at least in broad terms, the circumstances in which they may do so.** (6.2)

S31 The Islands appoint senior politicians as Chairmen of these Boards. I have no reason to think that this has caused problems in practice. **But the Islands would in my view do better to have professional regulatory Boards without political participation.** (6.4)

S32 **These Boards should preferably include members able to represent the interests of customers**, especially non-residents, as well as people with relevant professional backgrounds, **and one or two experienced people from outside the Islands.** (6.5)

S33 **The Boards should be non-executive.** Wherever possible they should delegate decisions on individual cases to the professional staff within agreed guidelines. (6.6)

S34 **The professional structures in all the Islands should preferably include a senior staff member at Director level with experience of supervising investment as well as senior staff for banking and insurance supervision; and a senior staff member to oversee the new regulation of Trust and Company services providers.** (6.7)

S35 **The structures should also preferably include a dedicated enforcement unit, as in the Isle of Man, with locus in civil proceedings and responsible for proactively policing the perimeter of unlicensed business.** (6.7)

S36 The Island authorities all accept an absolute obligation to *resource* their regulatory bodies adequately. **In my assessment, the FSCs in all the Islands, including for this purpose the Company Registries, need between 12 and 15**

**extra professional staff to support the strengthening and deepening of regulation and its extension to new areas.** Staff quality and experience are all-important. A mixture of home-grown staff and staff from outside is likely to be best. (6.8)

S37 **The objectives, duties and functions of the regulatory Boards should preferably be brought together in a single mandate statement** on the following lines:

- to protect customers, non-resident as well as resident, through effective licensing and supervision designed to ensure solvency, orderly markets and good conduct of business and to prevent fraud;
- to help prevent and combat use of the Islands' facilities for money laundering and other forms of financial crime;
- to co-operate fully with overseas authorities to these ends;
- to enhance the reputation of the Islands as finance centres;
- to develop regulatory policies accordingly and advise the Island's Parliaments on requirements for legislation; and
- to ensure that the Commissions are staffed and managed to deliver these functions to the highest standards. The actual terms of reference of the Island FSCs' follow this model fairly closely but not always comprehensively. (6.9)

S38 **The addition in all the Islands of an objective to further the Island's economic interests needs careful handling.** In my opinion, however, it is reasonable that the FSCs should have regard to the Islands' economic interests. (6.9)

S39 Promotional activities are another matter. The regulators' primary duties must be to protect the interests of customers and prevent abuses. They should never allow their impartiality to be compromised nor engage in hard selling of the Islands' facilities and industries. Phrases such as "promotion" of the Island or its industries should preferably be avoided. (6.9)

S40 **Rightly in my view, the Island authorities have extended (or in Jersey are about to extend) the *coverage* of regulation** to include investment business generally as well as banking and insurance business and collective investment funds.. They have plans as well to regulate company and Trust service providers. (6.10)

S41 **There is a corresponding need, in the Islands as elsewhere, to extend the *depth* of regulation.** The traditional emphases on solvency and liquidity need to be supplemented by new emphases on management and control systems, staff quality and competence, evaluation of market risk, systems for combating fraud and money laundering, and conduct of business issues in a broad sense. The Guernsey authorities in particular, but also the Isle of Man and Jersey authorities, have already made progress in these areas. **There is a case for developing new or extended principles, rules or codes of conduct to cover each of them.** (6.11)

S42 A further issue is whether the FSCs should have *prosecution powers*, in relation to a defined list of criminal offences, and *powers to impose penalties*. In my opinion such powers have considerable advantages but there is no absolute need for them. The Courts in all the Islands can impose fines for breaches of regulatory laws. For the FSCs, the essential requirements are effective enforcement powers and good links with the prosecuting and law enforcement authorities. **There is a compelling case, on the other hand, for powers to "*name and shame*" errant licence holders and those who operate without licences.** (6.12-6.13)

S43 The Islands' regulatory authorities have a policy of *full co-operation with overseas authorities* in the pursuit of crime or regulatory breaches. For the most part, the legislation provides the necessary powers. **The Isle of Man authorities might wish, however, to re-consider the requirement for approval by the Chief Minister before any information relating to individual customers can be passed. And I hope that the Jersey authorities will repeal the provision in the new Investment Business Law that prohibits FSC staff from passing to overseas regulators information relating to the identity of customers or others who have done business with a registered person.** (6.14)

S44 The legislation in Jersey and Guernsey makes breach of the regulators' statutory *confidentiality provisions* a strict liability criminal offence. This seems excessive. *It would seem better to provide, as the UK and the Isle of Man have done in the area of investment business, for a defence of due diligence*. (6.14)

S45 Only the Isle of Man has comprehensive *customer compensation schemes* in place to protect depositors, investors and policyholders if the providing institutions should fail. In Jersey and Guernsey, protection is limited at present to investors in

"recognised" collective investment schemes, though there are alternative arrangements for life insurance policyholders and UK policyholder protection may extend to some policyholders of Island branches of UK firms. Putting adequately resourced schemes in place may be difficult. **In my opinion, however, such schemes are an element in good practice and the Jersey and Guernsey authorities should consider introducing them.** EU Directives now require EU member states to have depositor and investor protection schemes. (6.15)

S46 None of the Islands has *financial services ombudsman schemes* for dealing with customer disputes. **In my opinion, the authorities in all the Islands should consider introducing such ombudsmen (or a joint ombudsman) as well.** For customers, institutions and regulators alike, the advantages should be considerable. Such schemes should cover non-residents as well as residents. Chapter 6 includes some detailed suggestions. (6.16)

S47 The authorities in all the Islands have provided extensive facilities to *train local staff* for work in the finance industries. (6.17)

*7 Banks*

S48 The FSCs in all the Islands have a *policy* to develop international banking sectors of high quality regulated to international standards. Most Island banks are subsidiaries or branches of the world's major banks. Regulation is based on the Basle Committee's core principles and, with certain variations, UK practices. Each of the Islands has up to date banking laws that provide the necessary legal framework. (7.2-7.5)

S49 In all the Islands, the FSCs exercise a careful quality control when licensing new banks. For the most part, they license banks only on the basis that their home supervisors will exercise consolidated supervision to the best international standards. The FSCs can then act as "host" rather than "home" supervisors. In Jersey and the Isle of Man, the FSCs undertake some "home" supervision for banks with subsidiaries outside the Islands. The Guernsey FSC, as a matter of policy, has not so far *licensed* such banks. (7.6-7.8)

S50 The FSCs follow the *traditional UK approach* to on-going supervision, based on off-site analysis of monthly and quarterly prudential and statistical returns and prudential meetings, mostly annual, with the banks' senior managements. They have close links with the banks' auditors, external and internal. External *auditors* have an obligation to "whistle-blow" to the FSCs. (7.9)

S51 The FSCs have made a start on *on-site inspections*, which form a key component in the Basle Committee's Core Principles. But they do not have the resources to implement full and systematic programmes. **They recognise that they will need to implement such programmes promptly, with help as necessary from reporting accountants, if full compliance with the Basle Committee principles is to be achieved.** (7.10)

S52 **The FSCs also accept the need to base supervision more closely on *risk assessments* for individual banks.** Only in Guernsey is there at present a structured risk-based differentiation in capital requirements, though both Jersey and the Isle of Man differentiate on a less structured basis. (7.10)

S53 In all the Islands (apart from a small anomaly in Guernsey), banks have to obtain the FSC's permission before taking on individual *risk exposures* above 25 per cent of capital. The main such exposures are to parent banks. **There may be scope for limiting the risks from these exposures through asset sale and repurchase arrangements.** (7.10)

S54 The FSCs in all the Islands obtain full maturity analyses of assets and liabilities for each bank. **There is a case for more structured monitoring and application of standard *liquidity* guidelines** in all the Islands, as in Guernsey. (7.10)

S55 The recent Jersey case involving Bank Cantrade confirms how right the authorities there have been to establish an independent FSC, bring in a new Investment Business Law and launch on-site inspections. It also reinforces the case noted above for developing Island Codes of Business Conduct throughout the finance sector. (7.11(a))

S56 **The FSCs in all the Islands should consider introducing and a confidential reporting line specifically for regulatory breaches and crimes.** (7.11.11)

S57 A Guernsey case, involving unlicensed deposit-taking by a fraudster, underlines the importance of having pro-active

and well-resourced enforcement units with effective powers of investigation and locus in civil proceedings, as in the Isle of Man, in all the Islands' FSCs. (7.11(b))

S58 The BCCI saga, which affected the Isle of Man as well as other branches, underlines the importance of initial vetting for licences. It has also confirmed the benefits of a Depositors' Compensation Scheme. (7.11(c))

S59 The FSCs seem understaffed for the tasks of banking supervision, especially on-site inspections. **The Jersey and Isle of Man banking teams seem each to need an extra two professional staff and the Guernsey team an extra one.** (7.12)

*8 Investment and securities business*

S60 The FSCs in all the Islands have a *policy* to regulate investment business to the highest international standards. All are members of IOSCO. (8.5)

S61 The Island authorities have licensed and regulated collective investment schemes, both open-ended and closed-ended, for over 10 years. In Jersey, regulation is now being extended to the other forms of investment business, including investment managers, investment advisers and stockbrokers. The Isle of Man has had a comprehensive regulatory regime since 1991 and Guernsey since July 1998. (8.6)

S62 Guernsey has supporting *rules* for investment business. The Isle of Man has *Codes of Conduct* with the status of rules. In both cases, the FSCs have power to enforce them. In Jersey, the Codes will not be similarly enforceable. **In my opinion they should be.** (8.6)

S63 The FSCs *license* and regulate institutions providing *collective investment schemes* along broadly UK lines, though with some differences. The issue of licences is carefully controlled. Licence criteria include the usual "fit and proper" assessments. Significant numbers of applications are refused. (8.7)

S64 Permits are also issued for individual schemes. The UK Treasury has granted "*designated territory*" status to all three Islands. This enables the Islands' industries to market "recognised" open-ended schemes to the general public in the UK. Such schemes have to meet UK-style requirements. Other "retail" schemes, too, require permits. For professional investor schemes, closed-ended schemes and debt issues, the requirements are lighter and less prescriptive. (8.7)

S65 The Island FSCs now have regimes similar to the UK's for licensing and regulating *investment activities other than schemes*, including dealing, arranging deals, fund management and investment advice. (8.8)

S66 In Jersey, however, the regime does not extend to *arranging deals*. In Guernsey, *long-term insurance products* are not counted as investments and are therefore not subject to investment conduct of business regulation. In the Isle of Man, these products are subject to such regulation if sold by independent financial advisers but not if sold by the insurance company's own staff. **The authorities in each of the Islands would preferably in my opinion make good these lacunas.** (8.8)

S67 The FSCs generally follow best practice in requiring *segregation of client assets* and accounts. **In Guernsey, however, the rules ought preferably to provide explicitly that assets held by a firm in the name of a client are held in Trust and are not available if the firm fails.** In the authorities' view, the Island's Trust legislation already provides such protection in practice. (8.9)

S68 All the FSCs have good programmes for *on-going supervision* of collective investment schemes. But on-site inspections are hampered by staff shortages. **Effective supervision of investment business other than schemes will require frequent on-site inspections, especially in the early years.** (8.10)

S69 Especially in Jersey and Guernsey, *outsourcing of back-office tasks* to units outside the Islands is increasingly common. This is an issue for supervision. **The solution may lie in co-operation with regulators or auditors in the jurisdictions where the back-office work is done** (which could include Alderney). (8.10.4)

S70 The legislation gives the FSCs wide powers to *investigate*. The Guernsey law needs amendment to reflect the ECHR Saunders judgment on self-incrimination. (8.10.6)

S71 The Isle of Man has extensive *enforcement* powers, matching those in the UK. The Guernsey authorities do not have powers to name and shame, seek injunctions against misleading statements, or ban individuals. The Jersey authorities do not have powers to apply for restitution for investors who previously suffered loss (except in collective investment schemes) or to seek injunctions and restitution for breach of regulatory codes. **The authorities in both Islands may wish to add these powers to their otherwise effective arsenals.** (8.10 (d))

S72 The Jersey authorities are preparing a new *Insider Dealing Law*. In all the Islands, securities violation and fraud should preferably be defined as widely as possible so as to ensure that co-operation can be given to overseas authorities. **In Guernsey, offences under the Law should include, as in the UK, Jersey and the Isle of Man, creating false markets in securities.** (8.11)

S73 The Guernsey FSC has announced plans for the introduction later this year of a *Channel Islands Stock Exchange (CISE)*. Management and supervision of a Stock Exchange are not simple tasks. **I hope therefore that the managing company and the FSC will give priority to thorough preparation in advance rather than an early launch.** (8.12)

S74 In all the Islands, there are pressures on investment supervision *resources*. **The Isle of Man FSC probably needs between two and three extra professional staff. The Guernsey and Jersey FSCs probably need one extra person each.** In Guernsey, the need arises in part from the new Stock Exchange. In Jersey the main need is to develop and deepen the approach to investment regulation. (8.13)

# 1 INTRODUCTION

### 1.1 Terms of reference

1.1.1 The Home Secretary commissioned me in January 1998 to review with the Island authorities in Jersey, Guernsey and the Isle of Man their laws, systems and practices for regulation of their international finance centres, the combating of financial crime and co-operation with other Jurisdictions. The terms of reference are at Annex A.

1.1.2 For the reasons discussed in Chapter 5, the three Islands are collectively known as Dependencies of the British Crown, or "Crown Dependencies". With the agreement of the authorities concerned, I have included the Islands of Alderney and Sark within the Review as well where this seems appropriate. The Guernsey Parliament can legislate for these two Islands in most criminal matters and, for Alderney, in certain "reserved" matters as well. In other areas, however, they have their own jurisdiction.

### 1.2 Report plan and contents

1.2.1 This Report presents the outcome of the Review. It consists of four parts:

- Part I presents my assessment, prepared with much help from the Island authorities, of the Islands' policies for regulating and policing their international finance centres.

- Parts II, III and IV, prepared by the Island authorities in consultation with me, are professional guides to the finance centres of Jersey, Guernsey and the Isle of Man respectively.

1.2.2 Part I reflects extensive discussion with the authorities and practitioners in the Islands and in London and some discussion with officials in other financial centres. It also draws on advice from four professional consultants mentioned below. I myself, however, take responsibility for what it says and for any errors of fact or judgment that it may contain.

1.2.3 The Part I assessment includes many expressions of opinion and suggestions alongside the analysis. These are intended to be helpful pointers, not dogmatic prescriptions, as to the way ahead. In a few areas, action does seem to be needed in a specific and precise form. Such areas are, however, the exception. More often, the nature of the requirement is clear in general terms, and generally accepted, but there are various options for its delivery. For the most part, therefore, the Report *either* encourages the Island authorities to continue (or reinforce) what they are doing already or makes alternative or additional suggestions which in my opinion they ought to consider (and in some cases to consider very seriously).

1.2.4 The professional guides in the Island sections (Parts II, III and IV) are prepared to a common design. In these sections, the Island authorities have sought to provide for each Island, within a manageable compass, professional exegeses of their political and judicial systems, their economies and finance industries, and their laws, systems and practices for financial regulation, company regulation, the pursuit of financial crime and co-operation with other Jurisdictions.

1.2.5 I hope that the Island sections will be of value to international institutions, Governments, judiciaries, regulators, law enforcement agencies and financial and legal practitioners inside and outside the Islands. I hope, too, that the Island authorities will be willing to keep them up to date and make them available on the Internet.

1.2.6 I would like to think that other Offshore Finance Centres, too, where information is often hard to come by, may be willing to prepare, keep up to date and make available professional guides of a similar kind, designed for similar audiences.

### 1.3 Review Team

1.3.1 The Review covers a wide range of subject matter. It has therefore been necessary to call on a variety of professional skills and experience.

1.3.2 I am grateful to Mr Munro Sutherland, Mr Guy Sears and a former insurance supervisor, who have looked at banking, investment and securities, and insurance supervision, respectively, in the Islands, and to Professor David Hayton, who has looked at various aspects of Trusts in the Islands. The main conclusions from their work are reflected in the Report.

1.3.3 I thank the Home Office for commissioning and financing the Review and providing some invaluable support services. I thank the Treasury for seconding Mr Michael Swan for a short but valuable period to assist with it.

### 1.4 Participation and Consultation

1.4.1 In conducting the Review, I have sought, and received, an enormous amount of help from many people inside and outside the Islands.

1.4.2 The authorities in each of the Islands have taken endless trouble. By the authorities, I mean not only the professional public servants, regulators, prosecutors and law enforcement officers, who have devoted much time to preparing the Island sections and to briefings and discussions, but also the leading politicians.

1.4.3 Also in the Islands, I have had the benefit of discussions with private sector financial practitioners, lawyers and accountants, both active and retired, as well as receiving many interesting letters from people living in or associated with the Islands.

1.4.4 In the UK, I have received much valuable briefing from Government officials, regulator staff, representatives of self-regulating bodies, private sector practitioners and professionals, and academic experts.

1.4.5 I have drawn heavily on advice from people with knowledge and experience of other "Offshore" centres, notably Gibraltar and the Caribbean. Mr Richard Chalmers of the Financial Services Authority, in particular, has been a constant source of help and advice as well as knowledge.

1.4.6 I have also learned much from discussions with officials and regulators of certain other countries and organisations which have dealings with the Islands, including the United States, Germany, France, Switzerland, the European Commission and the Financial Action Task Force.

1.4.7 I thank all these people for giving so generously of their time, knowledge and experience.

# 2 THE ISLANDS' FINANCE CENTRES

## 2.1 Overview

2.1.1 The development of the Islands' international finance centres, especially over the past 20 years, has been a remarkable success story. They have been considerable players in the wider development of "offshore" centres over this period.

2.1.2 The Islands have achieved this success with small populations. Their total population is now around 217,000. Jersey has 85,000 people; Guernsey, 59,000; and the Isle of Man, 73,000.

2.1.3 Each of the Islands now has a wide range of finance business, including banking, investment, insurance, company business and Trust business. The business has, moreover, become genuinely international. Customers now come from all parts of the world, not just the UK. Niche businesses have been developed, especially for multi-national companies, wealthy individuals and expatriates.

2.1.4 As the finance industry has developed, so the Islands have become more prosperous. In Jersey and Guernsey, GDP per head is now well above that in the UK.

2.1.5 The Islands have also become increasingly dependent on their finance centres. The finance industries and related services now account for well over half of the national income in Jersey and Guernsey and probably about one-half in the Isle of Man.

## 2.2 Offshore centres generally

2.2.1 The Islands have benefited from the rapid growth of international or "offshore" financial business generally in recent decades.

2.2.2 The terms "offshore centre" or "offshore business" tend now to be used in several different senses. They always include the business of:

- small Island finance centres, constitutionally independent at least as regards their domestic affairs, which have developed legislation, regulation and tax vehicles to attract non-resident business, mostly denominated in foreign currencies.

2.2.3 But they are also sometimes used to include, by analogy, the non-resident business of some or all of the following types of centre, all of which have seen rapid growth in recent years:

- similar small centres which are coastal or inland enclaves;
- special tax and/or regulation zones established by larger countries within their own borders;
- *any* finance centre, including the large world centres, with a large volume of non-resident clients.

2.2.4 As international trade, multi-national companies and holdings of personal wealth have grown, and exchange controls have progressively been dismantled, so offshore business in the widest sense has burgeoned at rates outstripping the growth of national incomes. It is estimated that one-third of the wealth of the world's "high net worth individuals", or approaching $6 trillion out of some $17.5 trillion, may now be held "offshore": that is, outside the Jurisdictions where the individuals live (Merrill Lynch & Gemini Consulting, World Wealth Report, 1998). The Crown Dependencies probably have about 5 per cent of this market.

## 2.3 Development of business in the Islands

2.3.1 The Crown Dependencies have attracted a certain volume of tax-driven business for several decades.

2.3.2 From the 1960s onwards, there began a rapid growth of offshore banking and associated niche products, accelerated by the development of multi-national companies, the growth of personal wealth world-wide and, from 1979, the progressive dismantling of exchange controls.

2.3.3 From the early 1980s and through the 1990s, this and related forms of business have grown strongly as the total offshore market has grown and the Islands have developed new financial products and services. Both corporate and individual customers have taken advantage of the tax and operational benefits of the offshore centres. This growth has continued despite tax and regulatory measures by the large Jurisdictions.

## 2.4 Nature of business

2.4.1 The Islands now have a wide range of finance business, including banking, investment, insurance, company business and trust business. The total assets and liabilities of Island institutions and Trusts probably now amount to some 300 to 350 billion.

2.4.2 Total bank deposits in the Islands (resident and non-resident) are currently around 170 billion (Jersey 100 billion, Guernsey 50 billion, Isle of Man 20 billion). For comparison, non-resident deposits held in the UK are around 1,000 billion.

2.4.3 Total collective investment funds under management by regulated institutions are about 63 billion (Jersey 38 billion, Guernsey 17 billion, Isle of Man 8 billion).

2.4.4 Insurance companies in the Islands have total assets of some 20 billion (Jersey 0.4 billion, Guernsey 7.4 billion, Isle of Man 12.3 billion, partly reflected in the earlier aggregates). Guernsey has 344 captive insurers and 10 authorised life assurance companies. The corresponding numbers in the Isle of Man are 177 and 15 in Jersey 10 and 3.

2.4.5 Apart from unit trusts, no figures are collected for the number of Trusts or the value of assets held in Trusts established on the Islands. The amounts held in this way are, however, believed to be very large, especially in Jersey (where Trust assets are believed to be around 100 billion) but also in Guernsey (where they are believed to be around 20 billion). Assets held in Trusts will be reflected in part, but only in part, in the bank deposit and assets under management figures quoted above.

2.4.6 Around 90,000 companies are incorporated in the Islands. Jersey has about 32,000, Guernsey about 16,000 and the Isle of Man about 42,000. Rather more than half these companies in each case are tax-exempt or subject to special non-resident tax regimes. Especially in Jersey and Guernsey, many more companies are administered from the Islands but incorporated elsewhere.

2.4.7 The table at Box 2.1 includes some of the figures just mentioned, along with similar figures for a selection of other offshore centres. Further details are in Boxes 2.2, 2.3, 2.4, 7.1, 8.1, 9.1 and 10.1.

## 2.5 Country distribution of financial institutions

2.5.1 Financial institutions in the Islands are mostly subsidiaries or branches of large parent organisations with head offices in the UK, Europe or North America. The size and nature of the Islands' business closely reflects the policies and decisions made by these parent institutions.

2.5.2 Although UK parentage still predominates, the parent institutions now come from a wide variety of other countries as well, as indicated in Box 2.2.

## 2.6 Country distribution of customers

2.6.1 In common with other "offshore" centres, the Islands' most important customers are companies operating on a global basis, wealthy individuals and expatriates. Niche markets have been developed, especially for these groups.

2.6.2 In earlier times, the Islands' finance business was heavily UK-oriented. Although the UK remains the most important single client, however, the business has grown to be genuinely international. The Islands' customers now come from all areas of the world, some directly and others via UK and other financial intermediaries.

2.6.3 UK customers, including companies, account for only 19 per cent of total bank deposits in Jersey. The corresponding figure in Guernsey is 15 per cent and in the Isle of Man 27 per cent.

2.6.4 The banks do however continue to invest a high proportion of their deposits and other liabilities in or through the UK. In Jersey, the proportion is 48 per cent; in Guernsey, 34 per cent; and in the Isle of Man, 55 per cent.

2.6.5 There is consequently a substantial net investment of funds from the rest of the world through the Islands' banks to the UK. This probably amounts currently to some 40 to 45 billion, equivalent to about one-quarter of total deposits held in the Islands.

2.6.6 In terms of currencies, sterling deposits now account for only some 37 per cent of the total (32 per cent in Jersey, 36 per cent in Guernsey, 68 per cent in the Isle of Man). In Jersey and Guernsey, more business is denominated in US dollars than in sterling. See Box 2.3.

## 2.7 Reasons for business

2.7.1 The Islands owe the success of their finance centres to their substantial constitutional independence in domestic affairs, their political stability and their continuing willingness, evident throughout their history, to adapt to changing world conditions. These are the vital factors from which all else flows.

2.7.2 The substantial independence of the Islands has enabled them above all, like other offshore and some onshore finance centres, to offer considerable tax advantages to customers. Local rates of personal and company income tax are 20 per cent in all the Islands. In addition, there is a wide range of concessionary regimes, especially for non-residents.

2.7.3 The tax advantages to particular customers depend not only on the Islands' own tax regimes but also on the regimes in customers' home countries or the other countries where they operate.

2.7.4 For non-resident private customers, however, and above all for expatriates, the non-taxation of interest paid to non-residents, and the absence of inheritance, wealth or capital gains taxes, may add up to a highly favourable tax environment.

2.7.5 For corporations, similarly, and especially the ever-increasing population of multi-national companies, captive insurance and asset holding vehicles, the various concessionary tax regimes for companies registered in but handling business originating outside the Islands, notably the tax-exempt and international business companies, may be highly attractive.

2.7.6 The Islands have rightly appreciated that tax advantages are a necessary but not a sufficient condition for success. Other elements are important as well. In these they generally have no inherent comparative advantage compared with the large centres. But they have worked hard to supply these elements as well:

Political stability
Respect for the rule of law
A good reputation
Good links with other respected Jurisdictions
An absence of corruption
Confidentiality
Good laws, preferably familiar from elsewhere
Good systems of justice and public prosecution
Good law enforcement

Good counter-crime and money laundering regimes
Good financial and company regulation, preferably familiar from elsewhere
Good and honest financial institutions, including major world names
Good company and trust vehicles, preferably familiar from elsewhere
Good and honest professional and supporting services at reasonable cost
A good economic infrastructure
A familiar local currency
A familiar language
Good communications

2.7.7 The continuing growth of the Crown Dependencies' financial business in recent years indicates the considerable success they have achieved in these areas as well.

2.7.8 The Islands' links with the British Crown and the UK, including the interlocking of legal and judicial systems, the close copying of UK legislation and regulation alongside their traditional independence in fiscal affairs, and the many UK parent institutions, have encouraged perceptions that they combine key advantages of the UK *and* the "offshore". They used sometimes to be known as "Offshore UK".

2.7.9 More recently, the presence on the Islands of many subsidiaries and branches of major financial institutions from the rest of Europe as well as the UK, and the adoption by the Islands of many EU standards, has encouraged a perception of the Islands as "Offshore Europe".

### 2.8 Living standards and public services

2.8.1 As the finance industry has developed, so the Islands have become more prosperous.

2.8.2 In Jersey and Guernsey, GDP per head was fairly close to that of the UK in 1980 but is now about 25 per cent higher in Jersey and about 20 per cent higher in Guernsey. These comparisons probably overstate the differences in living standards. Prices generally, and property prices in particular, are somewhat higher than in the UK. The Islands' GDP per head is boosted, moreover, by a minority of people with high incomes. Alderney and Sark appear to be less prosperous.

2.8.3 In the Isle of Man, GDP per head was 70 per cent of the UK level in 1980 and dipped to 57 per cent in the mid-1980s but has since risen to around 80 per cent.

2.8.4 The size of the public sector varies between the Islands. In the Isle of Man, as in most of the larger European economies, the ratio of public expenditure to GNP is about 40 per cent. In Jersey and Guernsey, the ratios are 32 and 20 per cent, respectively.

### 2.9 Dependence on finance business

2.9.1 The Islands have become increasingly dependent on their finance centres. Although the calculation depends heavily on the assumptions made, the finance industries and related services clearly now account for well over half of Island income in Jersey and Guernsey and for perhaps about one-half in the Isle of Man.

### 2.10 Differences between the Islands

2.10.1 Despite the similarities, the finance industries of the Islands exhibit some interesting differences.

2.10.2 Jersey has the largest banking, Trust and collective investment sectors but a relatively young insurance sector.

2.10.3 Guernsey is a major captive insurance centre as well as having substantial banking, investment and Trust sectors. The authorities there propose to introduce a Channel Islands Stock Exchange.

2.10.4 The Isle of Man combines the largest life insurance sector and substantial commercial insurance business with

smaller (but still sizeable) investment and banking sectors. The Island also has a significant shipping sector (not further discussed in this report).

2.10.5 The table at Box 2.4 shows the numbers of people employed in the banking, investment and insurance sectors of each of the Islands.

### 2.11 Comparison with certain other offshore centres

2.11.1 In terms of population, the Crown Dependencies are similar to Bermuda but approximately twice the size of Cayman and Gibraltar and three or four times the size of the British Virgin Islands (BVI). Compared with Hong Kong and Singapore, on the other hand, they are very small. In Jersey and Guernsey, population densities are high but far below those of Hong Kong, Singapore and Gibraltar and somewhat below that of Bermuda.

2.11.2 Jersey and Guernsey appear to have standards of living comparable with Hong Kong, Singapore and the BVI though some way short of Bermuda and Cayman.

2.11.3 In terms of business volumes, the Crown Dependencies have much smaller insurance sectors than Bermuda; much less banking and fund management business than Cayman; and a much smaller company registrations business than the BVI. But they are well diversified centres with substantial businesses in all these areas. Jersey's banking and fund management businesses, though much smaller than those of Hong Kong, are not far behind those of Singapore. The insurance sector appears to generate somewhat more premium income in Guernsey and the Isle of Man than in Singapore.

2.11.4 The Crown Dependencies compete for business not just with other centres traditionally regarded as "offshore" but also with special zones established within their own borders by the larger countries, such as the Irish International Financial Services Centre, and with countries such as Switzerland and Luxembourg which have developed similar kinds of non-resident business.

2.11.5 The table at Box 2.1 gives some comparative figures for selected centres.

### 2.12 Prospects for future growth

2.12.1 Looking ahead, the main brake on the continuing growth of Jersey and Guernsey as international finance centres is their size.

2.12.2 With total populations of some 85,000 and 61,000 respectively, population densities are already high, much higher than in the UK (about 1900 and 2040 persons per square mile, respectively, as against 600 in the UK). High proportions of the working populations in both Islands, about 20 per cent in each case, are already working in the finance industries or supporting services.

2.12.3 Even before the growth of the finance industries, the Islands were obliged to limit severely, through residence or housing permits, the inflow of newcomers to the Islands.

2.12.4 To accommodate significantly more people, as could anyway prove necessary for demographic reasons in Jersey, it could be necessary to construct high-rise buildings. This the Islands have been reluctant to do.

2.12.5 The alternative to such expansion will be to continue the existing policies of strict housing controls and rigorous selection of new business. The Islands will have to choose what financial business they do and do not want.

2.12.6 The Isle of Man, with 72,000 people, is less densely populated. Its population density, 316 persons per square mile, is about half that of the UK. A lower proportion of the total population is employed in the finance industry and supporting services. The scope for expansion of the industry is correspondingly greater. But the authorities have a policy to avoid undue reliance on any single industry and would be reluctant to see the Island's population density rise too far.

# 3 THE ISLANDS' REPUTATIONS

### 3.1 The Islands' reputations

3.1.1 In my discussions with professionals of wide experience inside and outside the Islands, I found widespread agreement that the Islands are in the top division of offshore finance centres.

3.1.2 Many of those I met expressed their admiration for what the Islands had achieved in recent decades, as discussed in Chapter 2. The Islands' financial institutions and professional services were seen as including able, creative and professional people.

3.1.3 The Islands were generally seen as scoring well against the checklist of items listed above in paragraph 2.7.6. They were also seen as comparing favourably with others among the smaller finance centres.

3.1.4 Many of my interlocutors mentioned good standards of government, regulation and business in the Islands and the absence of corruption.

3.1.5 Several of the overseas officials and regulators whom I met made special mention of how helpful individual people in the Law Officers' departments, Police, Customs and Regulatory authorities had been in assisting their investigation and prosecution of particular cases.

3.1.6 The Islands' co-operation with other Jurisdictions in the pursuit of drug-trafficking and terrorist offences won universal praise. So too did the systems the Islands had introduced for combating the laundering of money through financial institutions.

3.1.7 Mention was also made of other cases, involving fraud, market-rigging and VAT offences, where the Island authorities had provided exemplary co-operation and assistance.

### 3.2 Some concerns expressed

3.2.1 As one would expect, some of the professional people I consulted raised concerns as well. So too did some of the people of the Islands who wrote to me, in response to my general invitation, about the Review.

3.2.2 I do not regard the existence of such concerns as especially surprising or ominous.

All financial centres, onshore and offshore, have problems. All have their critics. The Islands are no exception.

3.2.3 I have, however, thought it important to evaluate the concerns carefully, in so far as they relate to the Islands' international finance centres, when developing my conclusions.

3.2.4 The areas of concern most frequently mentioned in relation to one or more of the Islands were as follows:

- some perceived conflicts of function and interest, especially among the authorities but also within the financial and professional sectors;

- a perceived absence of realistic means of redress (short of extended Court processes) for customers in dispute with institutions or others in the Islands;

- the continuation in business of firms or people with questionable track records;
- concerns about the scope for abuses by trustees;
- fears that too little was known about many companies operating in the Islands;
- anxieties about certain Island residents serving as Directors of companies incorporated elsewhere about which they knew little;
- fears that Island activities were depriving other countries of tax revenues; and
- fears that some Island people, in collaboration with colleagues in other Jurisdictions, were facilitating tax evasion and other forms of financial crime.

3.2.5 While some of these concerns seemed widely shared, others arose in relation to only one or two of the Islands. Others, again, were apparently minority views, but strongly held.

3.2.6 Some officials, regulators, investigators and prosecutors outside the Islands, similarly, felt that the Island authorities could sometimes have co-operated more effectively in the pursuit of crime. Here, too, the concerns did not apply equally to all the Islands. In most cases, the problem seemed to have lain in the absence of the necessary statutory powers, or in the interpretation of such powers. In others, the problem seemed to have lain in failures of communication or understanding. Occasionally, the problem was seen as lying in Island policies.

3.2.7 I do not think that all these concerns are relevant in all the Islands. I strongly suspect, moreover, that if I had sought to collect views on other international finance centres, the concerns expressed would have been at least equally serious. I have however discussed them carefully with the Island authorities, and these discussions have influenced the Report's conclusions.

3.2.8 Several correspondents gave me details of particular cases affecting them where they felt that something had gone wrong. I have not sought to judge the rights and wrongs of such cases. To do so would have been quite wrong. I have however considered what can be learned from them and what implications there may be for future development of the Islands' laws, systems and practices. These considerations, too, have influenced the Report's conclusions.

# 4 OBJECTIVES

### 4.1 Objectives

4.1.1 The Islands have a firm objective to be, or to remain, the best governed, best regulated and most responsible of offshore centres as well as the most successful.

4.1.2 It is clearly in the best interests of the Islands, the UK and indeed the international community that the Islands should set, and deliver, high standards in this way.

4.1.3 The continuing pursuit of such standards may sometimes discourage business, especially less reputable business. As many professionals have remarked, however, the Islands' best interests must lie in continued development of good business and rejection of business which is questionable or worse, especially as there is more than enough good business to keep the Islands occupied. In the medium and longer term, moreover, high standards will encourage, not discourage, the growth of business.

4.1.4 Chapter 17 discusses these matters further.

### 4.2 Practical implications

4.2.1 Fulfilment of the objective defined above will depend on maintaining and continuing to develop high standards in a number of areas:

- *public policies* and administration;
- *legal, judicial and prosecution* systems;
- the avoidance of *conflicts of interest*;
- the constitution of *regulatory authorities*;
- the legislation, systems and practices for licensing and regulation of *financial institutions*, including co-operation with other countries in the pursuit of regulatory offences;
- the legislation, systems and practices for registering and regulation of *companies, resident and non-resident*, and for dealing with insolvency;
- the common and statutory law for *Trusts and Trustees*;
- the licensing and regulation of *professional service providers, including company formation agents, providers of Director services and other providers of corporate, trust and investment services*;
- the laws, systems and practices for *policing* the finance centres and *combating crime* of all kinds, including money laundering and tax evasion as well as drug trafficking, terrorism and fraud; and
- *co-operation with other countries* in the pursuit of crime of all kinds.

4.2.2 To ensure the continuing achievement of high standards in an ever-changing world, there is a strong case for encouraging the development of effective international evaluation and accreditation of legal, regulatory and counter-crime

systems and practices in all the world's finance centres. I hope that the Islands will continue to be active in this area as well.

4.2.3 The remaining sections of the Report deal in turn with each of the areas mentioned, some briefly, others at greater length.

# 5 SOME ASPECTS OF GOVERNMENT

### 5.1 Introduction

5.1.1 For any international finance centre, political stability, public policy and administration, the legislative framework, the legal, judicial and prosecuting systems and the absence of corruption are key concerns. The Crown Dependencies have given much attention to all these areas.

### 5.2 Political stability

5.2.1 The Islands score highly on political stability. For many centuries, they have been dependencies of the British Crown, without ever being part of the United Kingdom. The United Kingdom is responsible for their defence and external relations and, in general terms, for their good government. By long-established constitutional convention, however, they are independent in matters of domestic policy.

5.2.2 Domestically, the Islands have maintained and gradually developed their political systems over many centuries.

5.2.3 As explained in the Island sections, the political systems of *Jersey and Guernsey* are directly descended from the 11th century Norman systems. The Islands' unicameral Parliaments, known in both Islands as "The States", are elected by universal suffrage, either directly or indirectly. They differ in six main respects from most Parliaments in the larger countries:

- First, the Parliaments combine the roles of legislature and executive. The main committees of the Parliaments discharge the functions of Government Ministries in larger countries. The Presidents of the Committees are not exactly Ministers but are the nearest equivalent to Ministers. As in larger countries, the Committees are supported by permanent civil servants.

- Second, the Parliaments combine the functions of central and local government in the larger countries. In some respects they function more like local councils in the UK than central governments.

- Third, the approval of the Queen in Council is required before most primary legislation passed by the Islands' Parliaments can take effect. Government Departments in London vet some of their legislation at the draft stage.

- Fourth, the Islands' Judges, known as the Bailiff and Deputy Bailiff, act as Speaker and Deputy Speaker of the Parliaments. The Bailiffs also act as first citizens and sometimes as spokesmen for the Islands.

- Fifth, there are traditionally no political parties. All members of the Islands' Parliaments are traditionally independent.

- Lastly, the Island Parliaments meet for only two or three days per month. Most members, including the Presidents of most Committees, do other jobs alongside their Parliamentary work.

5.2.4 The intertwining of the legislature and the executive in Jersey and Guernsey seems not so far to have been a problem in terms of external perceptions of the Islands as finance centres.

5.2.5 In both Islands, however, the Parliaments have recently commissioned reviews of the machinery of Government.

5.2.6 The *Isle of Man's* political system has an even more ancient ancestry but has undergone more change. The Island's Parliament, known as Tynwald, meets in plenary and bicameral modes.

5.2.7 The Island's domestic political system more closely resembles the systems of the larger countries in two respects:

- First, the legislature and the executive are separate. The Island has a Chief Minister, who acts as chief spokesman for the Island, and a Council of Ministers. Powers are vested in Departments of Government.

- Second, the President of Tynwald is not the Chief Justice of the Island but is elected by the Tynwald. The Judiciary play no role in the legislative or executive processes.

5.2.8 The Lieutenant Governor is able, moreover, to signify the Royal Assent to most primary legislation under powers delegated by the Crown.

5.2.9 In *all* the Islands, the links with the British Crown probably enhance external perceptions of political stability. The absence of political parties makes the outcome of particular Parliamentary votes somewhat less predictable but reduces the likelihood of major changes in policy after elections.

### 5.3 Relations with European Union

5.3.1 When the UK joined the European Union in 1973, the Islands decided to stay outside.

5.3.2 In Jersey and Guernsey, the main considerations at the time were:

- As offshore financial centres, the Islands needed above all to preserve flexibility in areas such as fiscal policy and financial and company regulation rather than be obliged to harmonise with the rest of Europe.

- Many of the Islands' clients made clear that the Islands were attractive as places for business precisely because they were outside the EU and the UK.

- There were concerns that the requirements foreseen for harmonisation of VAT and Excise duties would damage the tourist trade.

- Already overcrowded, the Islands could not readily accommodate obligations for the free movement of persons.

- The Island authorities doubted their ability to cope with the great mass of EU legislation.

5.3.3 The Isle of Man's decision was prompted mainly by a wish to preserve the Island's autonomy. The Island also wished to control its own taxation.

5.3.4 The Islands were concerned, nevertheless, to preserve their free trade in goods, including exports of agricultural products into the UK. They opted accordingly for free movement of goods (but not services, persons or capital) between the Islands and the EU.

5.3.5 In keeping with this, Protocol 3 of the UK's Treaty of Accession provides that the Islands shall be treated as part of the EU for Customs purposes and for trade in agricultural commodities, but not for other purposes. EU Directives and regulations relating to financial services, economic and monetary union and taxation do not, therefore, apply in the Islands. The authorities have opted in practice, nevertheless, to follow many aspects of EU legislation and standards in order to promote their business with EU countries.

5.3.6 The considerations listed above mostly remain pertinent today. The Islands prosper by being similar but different.

### 5.4 Public policy and administration

5.4.1 All the Islands have developed capabilities for formulating and implementing public policy remarkable for such small Jurisdictions. Especially in the areas of financial and commercial policy, they have followed UK practices in most respects and not sought to re-invent the wheel. They have also brought in experienced professionals from outside to give help where necessary.

### 5.5 Legislation

5.5.1 The Islands have likewise developed an impressive armoury of financial, company and criminal legislation. For the most part, they have been able to do this in spite of limited resources by closely (but not slavishly) following UK legislation, sometimes quickly, sometimes after considerable intervals.

5.5.2 The Jersey and Guernsey Parliaments meet for only two or three days per month but are able to pass legislation quickly. In contrast with Parliaments in the UK and most other large countries, there is no "Committee stage" in the passage of Bills. The established practice of using UK and other models for their legislation makes this less necessary.

5.5.3 In the Isle of Man, the legislature meets more often and Bills do pass through a Committee stage.

### 5.6 Legal systems

5.6.1 As implied above, the statute law which underpins the international finance and company business of the Islands is similar but not identical to UK statute law. The common or customary law systems in the Islands likewise have much in common, especially in commercial matters, with English common law, precedents from which are usually considered persuasive in Island proceedings.

5.6.2 The closeness of the Islands' law to English law brings two great advantages. First, it enables the Islands to enjoy many of the benefits of the legal system of a large Jurisdiction. Second, it is attractive to most customers of the Islands. English law is not only familiar but also well adapted to international financial business, both in its own right and because of the similarities in key areas to US law.

### 5.7 Judiciary

5.7.1 Especially in Jersey and Guernsey, the Islands' judicial systems have to deal with substantial amounts of business arising from the international finance centres.

5.7.2 The local structures, more fully described in the Island sections, differ in certain respects from those in England. The British Crown, however, appoints the senior members of the judiciaries, including members of the Courts of Appeal.

5.7.3 In *Jersey and Guernsey*, there are (separate) Royal Courts which hear all except minor cases, both criminal and civil. The presiding Judges of law are the Bailiff or Deputy Bailiff, both appointed by the British Crown after consultation with the Island authorities, or occasionally another Judge appointed by the Bailiff and sworn by the Court for a specific case. In addition, there are twelve judges of fact, called Jurats, elected by an Electoral College. Jurats are somewhat similar to Justices of the Peace in England.

5.7.4 In Jersey, the Royal Court consists for criminal trials of the Bailiff or Deputy Bailiff with a jury in some cases and with Jurats in others. In civil cases, the Court consists of the Bailiff or Deputy Bailiff and two Jurats.

5.7.5 In Guernsey, the Royal Court consists for criminal trials of the Bailiff or Deputy Bailiff and not less than seven Jurats. In civil cases the Court consists of the Bailiff or Deputy Bailiff and between two and four Jurats.

5.7.6 In both Islands the hearing of cases by a Judge with two or more permanent Jurats contrasts with the jury system in England. It has the advantage that the Jurats are mostly retired professional people with a good understanding of the often difficult financial and commercial issues which tend to be involved in the litigation of international finance centres.

5.7.7 Again in both Islands, as discussed earlier, the Bailiff serves as Speaker of the Island's Parliament and as First Citizen and spokesman of the Island as well as being the Island's Chief Judge. The Deputy Bailiff, similarly, serves as Deputy Speaker. Some of my correspondents argued for separating these roles, especially in a world where judicial review has become important, so as to put beyond doubt, in the perception as well as the reality, the independence of the Judiciary from the Legislature. This, however, is a constitutional issue which lies beyond the scope of the present report.

5.7.8 Others argued that judicial review remedies should be available in Guernsey and Alderney, as in the other Islands. This, too, lies beyond the scope of this Report.

5.7.9 The Appeal Courts in Jersey and Guernsey consist of three Judges drawn from panels comprising the Island's Bailiff, the Deputy Bailiff (in Jersey only), and a number of English, Scottish or Northern Irish QCs appointed by the British Crown after due consultation. In both Islands, the Bailiff (and in Jersey the Deputy Bailiff) do not usually sit on the Court of Appeal unless there is a strong local element that makes this appropriate. The Bailiff (and in Jersey the Deputy Bailiff) do not sit on the Court of Appeal if they conducted the first trial. The final Court of Appeal is the Judicial Committee of the Privy Council in London. The right of Appeal to the Privy Council is automatic in cases involving more than 10,000 in Jersey or more than 500 in Guernsey.

5.7.10 The *Isle of Man's* judicial system is closer to the English system. The Island's High Court hears all civil matters and serious criminal cases, including financial and fiscal cases. The presiding Judges, known as First and Second Deemsters, are appointed by the British Crown. In serious criminal cases, the presiding Deemster is accompanied by a jury of seven (twelve in murder cases). In most civil cases, there are no juries. In fraud and certain other cases, however, the Deemster sits with a jury of six unless the trial is likely to require prolonged examination of documents or accounts which a jury could not conveniently handle. The Deemster then sits alone or with one or more assessors, at his discretion.

5.7.11 The first Court of Appeal consists of the Deemster who did not hear the original case sitting with the Judge of Appeal, who is in practice always an English QC appointed for a five-year term by the Crown (though acting Deemsters may also be appointed to sit as members of the Court). This arrangement differs from that in Jersey and Guernsey where there are panels of judges as described above. The final Court of Appeal is again the Judicial Committee of the Privy Council in London. In contrast with Jersey and Guernsey, however, such Appeals may be made only by leave of the Court of Appeal or of the Privy Council itself.

### 5.8 Prosecution

5.8.1 Each of the Islands has an Attorney General who acts as public prosecutor. In Guernsey, the Attorney General is known as HM Procureur and is responsible for all prosecutions in all Courts of the Bailiwick.

5.8.2 In Jersey and Guernsey the Attorney Generals are supported by Deputies known as the Solicitor General and HM Comptroller, respectively, and Crown Advocates. In the Isle of Man, the Attorney General is supported by the Government Advocate.

5.8.3 The Attorney Generals, and in Jersey and Guernsey their Deputies as well, are appointed by the British Crown, after due consultation. They do not undertake any private work.

5.8.4 The Attorney Generals combine their public prosecution role with the further roles of:

- advising the Crown on legal matters;
- advising the Island Parliaments and Governments on legal matters (including in Guernsey and the Isle of Man, but not Jersey, responsibility for drafting as well as advising on legislation); and
- authorising various actions by the police and others under fraud, money laundering and other criminal legislation.

5.8.5 In Guernsey they also have to give their approval before any application can be made to the Royal Court for permission to register a company.

5.8.6 For any international finance centre, independent public prosecutors committed to prosecuting crime wherever there is a reasonable prospect of obtaining convictions are as important as independent judges.

5.8.7 A few of my correspondents in one of the Islands argued that the role of public prosecutor should not be combined with that of adviser to an Island's Parliament. They thought it wrong, for example, that the same person should *both* advise the Parliament or the Executive on legal aspects of their relations with someone *and* be responsible for the decision whether to prosecute him.

5.8.8 I suspect that any such conflicts of interest are likely to be rare. The Islands' Attorney Generals all recognise that, if conflicts should arise, their first duty would be to the Crown and their right course would be to advise the Parliament or the Executive to seek advice from others. Alternatively, if the conflict should arise from some earlier advice they had given to the Parliament, they would delegate the decision on whether to prosecute, and the prosecution itself, to someone else.

### 5.9 Resources

5.9.1 For the most part, the judicial and prosecuting authorities in all the Islands appear well able to deal with the business generated by the international finance centres.

5.9.2 In Jersey and Guernsey, workload problems have occasionally extended the timetables for law drafting, judicial processes and responses to requests for assistance by other Jurisdictions.

5.9.3 The authorities in all the Islands do however fully recognise the need for forward planning and management to ensure that sufficient staff with the necessary skills are available to handle the business of the international finance centres, with help as necessary from outside sources.

### 5.10 Conflicts of interest

5.10.1 One of the features that most distinguishes the best offshore finance centres from lesser centres is the avoidance of corruption and abuses arising from conflicts of interest. The Crown Dependencies have been keenly conscious of the need to avoid such abuses and have developed rules and procedures accordingly.

5.10.2 In small communities, the requirement to avoid, and be seen to avoid, these abuses is no less compelling than in larger countries. But such communities are unlikely to have sufficient reserves of skilled and able people to replicate entirely the separation of functions found in larger countries.

5.10.3 The issue is most apparent in relation to politicians. The leading *politicians* in small communities (as in local authorities) often combine political duties with business or professional work. Small communities cannot afford to debar from politics skilled and experienced people from other sectors.

5.10.4 The Islands have tackled the problem with considerable success by developing a culture of transparency coupled with good sense. Members of the Island Parliaments are allowed to retain commercial and professional interests. But there are rules on declaration of interests and dealing with conflicts of interest. These are included in publicly available legislation, standing orders, rules of procedure or guidance notes, which the Islands make a point of keeping up to date.

5.10.5 The rules oblige Members of the Island Parliaments, among other things:

- to record their interests in a public register, including employment, Directorships and investments where their interest exceeds 10 per cent (*all* investments in the Isle of Man); and

- to declare any relevant interests orally before participating in the discussion of any matter. In Jersey they are obliged to withdraw if they have direct financial interests.

5.10.6 In my opinion the rules or codes of good practice should include elements along the following lines where they do not do so already:

- an obligation that Members should not only declare their interests but also withdraw from meetings of the Parliament or any of its Committees when they have a financial interest in the matter under discussion;

- a presumption that Members should not accept Directorships or other paid positions when there might be a reasonable perception that they have been offered such positions only because they are Members of the Parliament; and

- a general presumption against accepting or retaining Directorships of companies, especially financial institutions,

directly involved in or affected by the Ministries or Parliamentary Committees on which they serve or have recently served.

5.10.7 The rates of pay for members of the Parliaments and Governments may need to reflect the restraints on other paid work, once again where they do not do so already.

5.10.8 An informal public policing of conflicts of interest is also highly developed in the Islands and, in my opinion, highly effective. As in other small communities, commercial and professional interests are not easily hidden. People in the Islands know much more about what their neighbours are doing than would normally be the case on the mainland. Local critics, moreover, are indefatigable in attacking politicians and others who may be thought to have committed abuses. My impression is that the critics may even sometimes identify conflicts that do not really exist.

5.10.9 The formal arrangements discussed above relate primarily to Jersey, Guernsey and the Isle of Man. In the smaller communities of Alderney and Sark, the formal arrangements for declaring and dealing with conflicts of interest are less highly developed.

5.10.10 The Islands apply much the same principles and practices to the *Financial Services Commissioners* who oversee the independent regulatory authorities for the financial services industries. In this case, however, they quite often appoint people still active in the finance industries or the related professions on the basis that both the regulatory authorities and the industry will benefit from the contributions such people can make. In my opinion this approach is entirely justified provided that there is (among other things) scrupulous observance of the other principles set out above. Chapter 6 discusses these matters further.

5.10.11 In all the Islands, the *Judges* and *Public Prosecutors* are debarred from holding private sector appointments or doing private sector work alongside their official duties.

5.10.12 *Public servants*, similarly, require special permission to earn income from any source other than their public employer. They are not permitted to use for private profit information obtained from their official work.

5.10.13 In the *private sector*, too, there is considerable scope for conflicts of interest, not least in relation to auditing functions and client services. The Islands' professional practices have, however, mostly split off their audit work from their Trust and other work. In addition, the Islands' proposals to regulate the provision of corporate and trust services will help to identify and prevent other potential conflicts.

5.10.14 All in all, therefore, the Island authorities seem to me to have developed good procedures for dealing with potential conflicts of interest, not least those that would most affect their financial centres. They have responded positively to changing international standards and attitudes. Some critics of the Island authorities continue to voice anxieties. In my opinion, these need to be taken seriously but would be substantially resolved, to the extent they have not been resolved already, by putting in place any outstanding elements in the good practice programme discussed above.

# 6 FINANCIAL REGULATION: OBJECTIVES, STRUCTURES AND POLICIES

### 6.1 Objectives

6.1.1 All the Island Parliaments have set firm objectives to have well regulated finance centres with effective and up to date legal, judicial and regulatory frameworks. There has been general agreement that high standards of regulation are not only an absolute obligation for any world-class finance centre, on-shore or offshore, but also in the best interests of the Islands themselves and their industries.

6.1.2 The Islands have seen the key tasks of regulation as being:

- to protect customers, both resident and non-resident, by reducing the risk of losses due to fraud, incompetence or other deficiencies; and
- to enhance the reputation of the Islands as financial centres; while also
- furthering the economic interests of the Islands.

6.1.3 There has also in recent years been an increasing emphasis on overseeing systems to combat money laundering.

6.1.4 The broad approach in each of the Islands has been to follow UK standards and styles of regulation, with adjustments for the particular requirements and risks of centres serving mainly non-resident customers.

6.1.5 The Islands have also pursued a policy to comply with international and EU standards of regulation and to join the relevant international regulatory bodies wherever possible. The main such bodies are the Offshore Group of Banking Supervisors (OGBS), sponsored by the Basle Committee on Banking Supervision; the International Organisation of Securities Commissions (IOSCO); and the International Association of Insurance Supervisors (IAIS).

6.1.6 In pursuit of these broad objectives and approach, the Island Parliaments have taken responsibility for setting the overall policy and legislative framework for financial regulation but have set up independent Financial Services Commissions to advise on and implement the regulatory regimes. This accords with best international practice.

### 6.2 Parliamentary Committees and Government Departments

6.2.1 The Parliamentary Committees or Government Departments in the Islands responsible for promoting financial legislation and overseeing the financial regulatory authorities are the Finance and Economics Committee in Jersey, the Advisory and Finance Committee in Guernsey and the Treasury in the Isle of Man.

6.2.2 The *Isle of Man* Parliament set up an independent Financial Supervision Commission (FSC) in 1983, as part of its response to the Savings and Investment Bank collapse in 1982. The regulation of Insurance was transferred in 1986 to a separate Insurance Authority, which was later made responsible for supervision of pension schemes as well and is now known as the Insurance and Pensions Authority (IPA).

6.2.3 The *Guernsey* Parliament set up an independent Financial Services Commission (FSC) in 1988, partly in response to a Report on the insolvent liquidation of Barnett Christie (Finance) Ltd in 1978. The Guernsey FSC covers insurance and company registration work as well as the regulation of financial institutions.

6.2.4 In *Jersey*, the Finance and Economics Committee of the Island Parliament continued until this year to act as Regulator of the Island's finance industries with the support of public servants in the Financial Services Department. The Parliament decided last year, however, to set up a Financial Services Commission (FSC) on similar lines to the Guernsey Commission and the new Financial Services Authority in the UK. The new Commission came into being on 1 July this year.

6.2.5 In *all the Islands*, the Parliaments approve appointments to the Boards of the independent regulatory authorities, on recommendations by the relevant Committee or Department. The Parliaments in Jersey and Guernsey, and the Treasury and the Council of Ministers in the Isle of Man, also retain the right to give written directions of a general nature (but not on specific cases) to the regulatory authorities, as well as passing the necessary financial, company and Trust legislation.

6.2.6 In my opinion, the Island Parliaments have been right to set up independent regulatory authorities while retaining the powers mentioned in the previous paragraph. The task of regulation is better performed by suitably qualified independent professional people than by politicians or Government officials with other axes to grind. Independence also enables the regulatory authorities to pay the amounts needed to attract staff of the right calibre and experience in adequate numbers, outside the traditional restraints on public sector pay and staff numbers.

6.2.7 The Island Parliaments have powers to dismiss the Regulatory Boards. As in Jersey, the statutes should preferably specify, at least in broad terms, the circumstances in which they may dismiss either the Boards or individual members.

### 6.3 One or more regulatory bodies

6.3.1 The Islands differ in the number of regulatory bodies they have and the division of tasks between them. The main differences relate to (a) insurance and pensions supervision and (b) the registration and regulation of companies.

6.3.2 On *insurance and pensions* supervision, the position is:

- In *Jersey and Guernsey*, the Financial Services Commissions (FSCs) regulate the financial services institutions as a whole, including insurance and pensions business as well as banking, investment and securities business.

- In the *Isle of Man*, as discussed above, a separate Insurance and Pensions Authority (IPA) regulates insurance and pensions business.

6.3.3 On the *registration and regulation of companies*, the position is:

- In *Jersey*, the FSC (and the Financial Services Department before it) is responsible for vetting, registering and regulating companies. The company registry forms part of the FSC.

- In *Guernsey*, the Royal Court approves company registrations. The Register is kept by an officer of the Court known as the Greffier. Applications can be submitted only by Advocates of the Royal Court, who are obliged first to conduct due diligence and then to clear the applications with the FSC and the Law Officers. The FSC undertakes the main work of vetting.

- In the *Isle of Man*, the Companies section of the Island's General Registry is responsible for registering companies. Registration is automatic provided that the correct documentation is submitted. There is a proposal, however, to transfer the Companies Registry and responsibility for companies supervision into the Island's FSC in the first half of 1999.

6.3.3 In my opinion, there is no absolute requirement to have one regulatory authority rather than two or three. The regulation of insurance business and companies both call for particular knowledge and experience and can, if desired, be handled by separate bodies.

6.3.4 On the other hand, especially in small jurisdictions like the Islands, the case for a single regulatory authority, responsible for the whole range of financial, company and Trust services, seems powerful. Such an approach is likely:

- to be more economical in terms of accommodation and overheads, including Board servicing and support staff (an important consideration in small communities);

- to facilitate flexibility and cross-fertilisation in the deployment of professional staff;

- to help in the supervision of conglomerates and of kinds of business common to insurance and other kinds of financial institution, notably investment business (where consistency of treatment is important); and

- to facilitate effective oversight of the Islands' company sectors through properly co-ordinated regulation (including effective enforcement) of companies and providers of company and Trust services.

6.3.5 In my opinion, therefore, the Isle of Man authorities' proposal to transfer responsibility for companies supervision to the FSC is entirely right. I hope that the Island authorities will seriously consider transferring responsibility for the supervision of insurance and pensions to the FSC as well.

6.3.6 The Guernsey authorities, similarly, may wish to consider the case for making the FSC the company registration authority. As discussed in Chapter 10, the Jersey and Guernsey authorities seem in general to have been successful in their policies for vetting company registrations. The Guernsey procedures do, however, seem rather heavy.

### 6.4 Board structures: political participation

6.4.1 As already explained, the Island Parliaments approve the appointments of Board members of the FSCs and the IPA on the recommendations of the responsible Parliamentary Committee or Government Department. This accords with standard international practice.

6.4.2 The Islands depart from standard international practice in the larger countries in their choice of Chairmen for the regulatory authority Boards. In Jersey and Guernsey, the Chairman of the relevant Parliamentary Committee serves as Chairman of the FSC Board. In the Isle of Man, similarly, one of the Members of Parliament who comprise the Island's Treasury team serves as Chairman of the FSC and another as Chairman of the IPA.

6.4.3 I have no reason to think that the appointment of senior politicians as heads of the regulatory authorities has led to significant problems in practice. The arrangement has the advantage that the politicians who Chair the regulatory authorities are well placed to brief the Island Parliaments whenever they need to pass new regulatory legislation or approve new Board appointments. The Island Parliaments themselves may have felt happier about the initial decision to delegate such a crucial task to an independent Board in the knowledge that one of their own number would Chair the Board and be available to report back to them.

6.4.4 There are also, however, some clear advantages in confining Regulatory Boards to non-political professional people.

6.4.5 Not least among these is the widespread perception elsewhere, which has tended to strengthen in recent years, that regulatory Boards *should* be constituted in this way. Any appearance that the decisions by the Regulatory Board of an international finance centre might be subject to political influence is likely to detract from the centre's reputation.

6.4.6 The substantive case is that the business of regulation is a professional task, requiring professional direction and impartial implementation. Regulators, like judges, need to be independent, impartial and professional, both in the reality and in the perception. It is difficult, however, for politicians, even if they have the necessary professional backgrounds, to be visibly impartial in this way when their daily tasks include public arguments about political strategies and public responses to political pressures and critics.

6.4.7 It is also difficult for public figures to refuse to be drawn into discussion and controversy over particular regulatory decisions. For their own protection, therefore, it seems better that they should not serve on regulatory Boards.

6.4.8 If regulator Boards do not include politicians, other ways must be found to maintain good links with the Legislature and Executive. Fully professional Boards should continue, of course, to be accountable to the Island Parliaments and should be required to report to them at least once a year. On a continuing basis, good links can be forged by various means. These may include attendance of a senior civil servant as an observer at Board meetings, regular meetings between the Board Chairman and the senior politician concerned, and appearances as required by the regulatory Board Chairman before the relevant Government Departments or political committees.

6.4.9 For all the reasons discussed, and well though the present arrangements seem to have worked in practice, the Islands

would in my opinion be well-advised to consider moving to independent professional regulatory Boards without political participation.

### 6.5 Board structures: balance of members

6.5.1 The other main issues on the structure of regulator Boards are the numbers and the balance of membership between professionals and customer representatives and between people from inside and outside.

6.5.2 The present Island Board members vary in numbers and backgrounds between the Islands. The Jersey and Isle of Man FSCs each have 7 Board members. The Guernsey FSC has 5. The Isle of Man's IPA has 4. In Jersey and the Isle of Man, but not in Guernsey, the Director Generals of the FSCs are Board members.

6.5.3 Regulator Boards should clearly include people with relevant professional backgrounds who can contribute substantively to the Board's business. This happens in all the Islands.

6.5.4 The Boards should also preferably include people familiar with and sensitive to the interests of depositors and investors, not least those who are non-resident. Periodic contact with investor groups elsewhere, for example in the UK, may also be helpful.

6.5.5 In a different perspective, there is a strong case in small jurisdictions for having on the regulatory Boards one or two experienced people from outside the jurisdiction as well as people sensitive to the interests of the jurisdiction itself. The Isle of Man's IPA has two outsiders and Jersey's new FSC has one.

6.5.6 Also relevant to decisions on the balance between people from inside and outside the jurisdiction will be the international experience of those from inside the jurisdiction and the proportion of professional staff from outside. It will shortly be the case that the Director Generals of all the Islands' regulatory bodies will have come from outside. The overall proportion of staff from outside is especially high in the Guernsey FSC.

6.5.7 In practice, many Board members of the regulatory authorities will fall into two or more of the categories listed above.

6.5.8 As discussed in the previous Chapter, the provisions for dealing with conflicts of interest are similar to those for members of the Island Parliaments.

### 6.6 Non-executive Boards

6.6.1 The Islands vary in the extent to which the Boards of the regulatory authorities become involved in the work of regulation. The Isle of Man's FSC Board appears to involve itself more deeply than those of the other regulatory bodies.

6.6.2 All Boards see themselves as responsible for setting policy and for approving the administration and budgeting decisions of the Director General. In the Isle of Man, licensing and licence withdrawal decisions, too, mostly require approval by the Boards themselves. In Jersey and Guernsey, these tasks too are mostly delegated to the Director General.

6.6.3 Other regulatory decisions are mostly delegated to the professional staff. But the staff make regular reports to the Boards.

6.6.4 In my opinion, regulator Boards should wherever possible avoid becoming involved in decisions on individual cases. They should also as far as possible leave the professional staff to make individual licensing decisions within agreed guidelines. The more the Boards themselves are involved in decisions on individual cases, the less possible it becomes to find well-qualified people without conflicts of interest to serve on them.

### 6.7 Professional structures, including enforcement units

6.7.1 The Guernsey FSC is organised by type of business supervised, with a Director General's Division and three further

divisions looking after banking, investment and securities and insurance respectively. The Jersey FSC will initially be organised along similar lines. But consultants have been commissioned to advise on the future organisation.

6.7.2 As discussed above, the Isle of Man regulates insurance and pensions through a separate Insurance and Pensions Authority. The FSC, however, is organised, not by type of business supervised, but by type of work undertaken. There are separate divisions for supervision (of banks and investment and securities business), policy development, enforcement and information and communications technology.

6.7.3 From one perspective, the differences are less than might appear. The Director General's division in Guernsey effectively looks after matters that would fall to the policy development, enforcement and IT divisions in the Isle of Man. In contrast with Jersey and Guernsey, however, a single Director covers both banking and investment business in the Isle of Man.

6.7.4 The most notable difference is on enforcement. In the Isle of Man, a separate and proactive enforcement division with three professional staff, including a former police officer, undertakes the enforcement tasks, especially in relation to unlicensed business, including responsibility for identification of unlicensed business operations, investigations and searches, restraint, confiscation and recovery of assets, and responses to requests for assistance from regulatory authorities in other jurisdictions. This seems to me to work extremely well. The Isle of Man's FSC also has a prosecution role. The enforcement division leads on this, too.

6.7.5 In Jersey and Guernsey, the banking, investment business and insurance divisions are each responsible for enforcement within their own areas. In Guernsey, however, a single staff member in the Director General's division in Guernsey undertakes some of the same responsibilities as the Isle of Man's Enforcement Unit. In all cases legal and other specialist help is bought in from outside when required.

6.7.6 Having looked at the professional structures of the Islands' FSCs, I believe that there is one important point for consideration by each of them.

6.7.7 First, I believe that the Isle of Man's FSC should consider the case for having four professional supervisors at Director level alongside the policy and enforcement Directors, rather than one as at present: a Banking Director, an Investment Director, an Insurance Director (if the two regulatory authorities are merged) and a Companies, Trusts and Service Providers Director (to implement the proposed extension of the regulatory boundary to the service provider areas). The other FSCs, too, are likely to need an extra person or persons at this level to deal with the licensing and regulation of fiduciaries and service providers.

6.7.8 Second, I believe that Jersey and Guernsey FSCs should both consider introducing a dedicated enforcement unit with proactive powers, headed at Director level, along the same lines as the Isle of Man's enforcement division. The advantages in having such a unit seem to me considerable:

- First, the importance of the enforcement function can hardly be exaggerated. All regulator bodies need to give priority to putting out of business practitioners who are likely to let their customers down though dishonesty or incompetence.

- Second, enforcement activities such as investigation, collection of evidence, seeking of Court Orders and civil remedies, including restraint, confiscation and recovery of assets, winding up of firms and disqualifications of individuals, are specialist tasks which require specialist skills, training and practice.

- Third, such tasks tend to arise at short notice and can be highly disruptive to well-planned inspection programmes, both on and off site. They can also arise in relation to businesses which do not fall neatly into the traditional regulatory categories, non-regulated as well as regulated.

- Finally, there is a danger that, in the absence of a dedicated enforcement unit, no one inside or outside the regulatory organisation will feel responsible for identifying, pursuing and prosecuting unauthorised operations. This task will become the more important when the regulatory boundary is extended to include service providers and the supervision of companies is strengthened.

6.7.9 An effective enforcement unit needs suitable legislation to enable it to fulfil such tasks and in particular to give it locus in civil proceedings.

### 6.8 Resources

6.8.1 The ratios of regulatory staff to levels of business and numbers of institutions monitored vary to some extent between the Islands. Excluding company registration staff, the Jersey FSC has 31.5 staff including 15 with professional qualifications. The corresponding figures for Guernsey are 36 and 15; and for the Isle of Man, 32 and 18, spread between the FSC and the IPA.

6.8.2 The studies made by the specialist regulators as part of this project suggest that in some areas more qualified staff are needed to discharge the present tasks of regulation, especially in the areas of on-site inspections and investment business. The position varies, however, between the Islands.

6.8.3 The Island authorities accept that extra staff will also be required to sustain the extension of the regulatory boundary to include corporate and Trust services providers (Chapter 13) and, in Jersey and Guernsey, a fuller coverage of investment business (Chapter 8). Suitably qualified staff for the first area in particular will not be easily found. The Jersey authorities foresee the need for 5 extra professional staff in these areas.

6.8.4 The Island authorities all accept that they have an absolute obligation to resource the regulatory tasks adequately, even if licence fees have to rise. For an international finance centre, adequately staffed regulation is clearly essential, not just desirable. The authorities propose therefore to recruit the extra resources needed as soon as practicable.

6.8.5 The precise scale of the requirement is for the authorities in each Island to determine. My impression, based on the studies of the specialist regulators and further discussions, is that between 13 and 15 extra staff are likely to be needed in each Island (see further Chapters 7, 8, 9, 13 and 18). This includes the significant extra requirements for supervision of companies and service providers (see Chapters 10, 12 and 13).

6.8.6 The Islands also vary in the extent to which they have brought in professional staff from the UK and other jurisdictions. Guernsey has 8 such staff, including the Director General and the Directors. The Isle of Man employs 15 professional staff brought in from outside, including the present and past FSC Director Generals. Jersey has relied more heavily on home-grown talent but has 3 regulators at Director level and a Director General in waiting from outside the Island.

6.8.7 In my opinion, the best strategy is to have a good mixture of staff from overseas and home-grown talent. The presence of a significant number of staff from overseas is advantageous in terms of perceptions of the Islands as well as for the extra dimensions of experience they can bring.

### 6.9 Terms of reference

6.9.1 The statutory duties and terms of reference of the regulatory Boards in the Islands mainly reflect the objectives set out in the first section of this Chapter.

6.9.2 As the Island sections illustrate, there tend to be several different texts setting out the Boards' duties and objectives. These include statutory provisions, policy statements and mission statements.

6.9.3 The authorities may find it helpful, where this does not happen already, to bring all such material together in a single statement of objectives, duties and functions.

6.9.4 The Boards' key objectives and duties should, in my opinion, be as follows:

- to protect customers, non-resident as well as resident, through effective licensing and supervision designed to ensure solvency, orderly markets and good conduct of business and to prevent fraud;
- to help prevent and combat use of the Islands' facilities for money laundering and other forms of financial crime;
- to co-operate fully with overseas authorities to these ends;

- to enhance the reputation of the Islands as finance centres;
- to develop regulatory policies accordingly and advise the Islands' Parliaments on requirements for legislation; and
- to ensure that the Commissions are staffed and managed to deliver these functions to the highest standards.

6.9.5 With the exception of the Isle of Man's IPA, the actual terms of reference of the Islands' regulatory bodies, together with other provisions and statements, follow this model fairly closely. One or two elements, however, are sometimes omitted. In my opinion, all elements are important.

6.9.6 In all the Islands, one or other of the relevant texts includes an additional duty or principle of furthering the economic interests of the Islands. In Jersey, the legislation requires the FSC to have regard to the best economic interests of the Island. The Guernsey legislation includes an objective to take such steps as the Commission considers necessary for development of the Island's financial business. In the Isle of Man, too, the FSC's mission statement refers to economic benefit to the Island.

6.9.7 The Jersey legislation also includes a further objective to "promote" the Island as a centre for financial services.

6.9.8 In my opinion, it is reasonable to look to the regulatory authorities to *have regard to* the economic interests of the Islands, especially when the Islands are as dependent as they are on their finance centres and have in practice to ration the number of people who establish businesses on the Island.

6.9.9 It is also right and proper that regulators should play their part in conveying information about the finance centres, and not least about the regulatory regimes.

6.9.10 Phrases which refer to "promotion" of the Island or its industry, on the other hand, risk giving a wrong impression. "Promotion" in the sense of hard selling or marketing is clearly not a proper task for regulators. Such a task, if needed, is better left to the Parliamentary Committee or Government Department which oversees the finance industry, in co-operation with the industry itself. For regulators, impartiality is an absolute requirement, both in substance and in the appearance, and "promotion" in the sense just defined cannot be reconciled with this. The same person cannot readily "promote" the Island's facilities to potential newcomers one day and appear on the following day in the role of an impartial licensor or regulator.

6.9.11 In my opinion, this is mainly a problem of language rather than substance. But the language of statutes and mandates is important, not least in influencing behaviour over time. The word "promotion" ought preferably, therefore, to be avoided.

# 7 BANKS

### 7.1 Introduction

7.1.1 This Chapter draws on a review of banking regulation in the Islands commissioned by the Home Office at my request from Mr Munro Sutherland. I am most grateful to Mr Sutherland.

### 7.2 Scale of business and tax status

7.2.1 Jersey and Guernsey are international banking centres first and foremost. In June 1998, their banks had total deposits of some 100 billion and 50 billion, respectively. The Isle of Man too has a substantial banking business, with deposits of some 20 billion.

7.2.2 As indicated in the Box 7.1 table, all three Islands have between 70 and 80 licensed banks (including UK building society branches in the Isle of Man). But the average size of business, measured by total assets or deposits, varies. Jersey's pursuit of larger-scale business is reflected in average deposits of 1.26 billion per bank. Guernsey banks have average deposits of 660 million and Isle of Man banks 290 million. These averages do, of course, mask large variations between individual banks.

7.2.3 Jersey banks employ 4,700 staff (more than half of total finance centre staff). Guernsey banks employ some 2,700 staff (less than half of total finance centre staff). The Isle of Man banks employ 1,800 staff (about one-third of finance centre staff).

7.2.4 The banks on the Islands are mostly subsidiaries or branches of large parent banks in the UK, the rest of Europe, North America and Australasia. With limited exceptions, they are constituted as locally registered companies subject to the normal 20 per cent rate of tax on corporate profits.

### 7.3 Type of business

7.3.1 In all the Islands, the main types of banking business are:

- *deposit-taking*, especially from expatriates, mostly on-lent to parent banks in the UK and elsewhere, and
- *private banking* for wealthy individuals, often associated with asset management, custody and Trust business.

7.3.2 Parent banks in the UK, the rest of Europe, North America and Australasia introduce much of this business. The Islands' banks mostly form part of group structures with wide international coverage. Some banks undertake substantial Trust and company services business as well.

7.3.3 In Jersey and (to a lesser extent) the Isle of Man, but not at present in Guernsey, some of the banks have subsidiaries or branches outside the Island.

### 7.4 Distribution of business

7.4.1 As the Box 7.1 table indicates, the Islands' banking businesses are no longer predominantly with the UK. In Jersey, Guernsey and the Isle of Man, UK residents account for some 19, 15 and 27 percent of deposits, respectively.

7.4.2 The proportions of money market placements in or through the UK are significantly greater, at 48, 34 and 55 per cent, respectively, of total liabilities. As discussed in Chapter 2, therefore, there is a substantial net investment of funds through the Islands' banks into the UK. After allowing for non-deposit liabilities from UK sources, this probably amounts currently to around 40 to 45 billion.

7.4.3 In Jersey and Guernsey, bank deposits are predominantly in foreign currencies. Sterling deposits are 32 and 36 per cent, respectively, of the whole. The Isle of Man remains more sterling-centred, with 68 per cent of deposits in sterling.

### 7.5 Regulatory policy and legislation

7.5.1 The authorities in each Island have a policy to promote international banking sectors of high quality regulated to international standards.

7.5.2 To that end, there is a firm objective in all cases to meet the Basle Committee's Core Principles for banking supervision. The licensing and regulation of banks in all the Islands are based on Basle Committee principles and, with certain variations, UK practices.

7.5.3 Each of the Islands has up to date banking laws that provide the necessary legal framework: the Banking Business (Jersey) Law, 1991, as amended, the Banking Supervision (Guernsey) Law 1994, as amended, and in the Isle of Man a new Banking Act 1998. The Island sections give the details.

### 7.6 Licensing

7.6.1 In all the Islands, the authorities carefully control the licensing of new banks. This is in my opinion, a source of strength.

7.6.2 Taking the Islands in turn,

- The Jersey authorities have a policy to admit only banks from the world's top 500 banks in terms of capital. Within this, they have sought to attract some of the largest US, Canadian and European banks as well as the top ten UK banks. They are also concerned about fit and proper testing.

- The Guernsey authorities pursue a similar policy of rigorous vetting, with rather less emphasis on size and more on the quality and nature of the business.

- The Isle of Man authorities have a policy to assess banks' quality rather than size through stringent "fit and proper" testing.

### 7.7 "Host" and "home" supervision

7.7.1 In all the Islands, the authorities are mostly "host" rather than "home" supervisors. This, too, is a source of strength. As discussed above, most of the banks are subsidiaries or branches of major banks overseas. The authorities license them only with the agreement of their home supervisors and on the basis that the latter will exercise consolidated supervision in accordance with the internationally accepted conventions.

7.7.2 Once again, the position varies somewhat between the Islands:

- The Jersey authorities are prepared to allow Jersey registered banks to act as regional "hubs" and to have subsidiaries or branches elsewhere. In these cases, the authorities have to exercise more than host country supervision.

- The Guernsey authorities, as a matter of policy, have not so far allowed this. Their supervisory duties are therefore currently limited to "host" country duties.

- The Isle of Man authorities have a general policy not to license operations requiring more than "host" country supervision. But they do still retain some such responsibilities.

### 7.8 Other points on licensing

7.8.1 Some other differences, compared with UK practices on licensing, are:

- *Economic benefit criterion*. The Jersey and Guernsey legislation obliges the authorities to consider the economic benefit to Jersey and Guernsey. As discussed in Chapter 6, this seems to me acceptable, especially in a context where more institutions wish to come than can in practice be accommodated, provided that in any case of conflict the regulator always puts prudential requirements first. The authorities in both Islands have a firm policy to do this. The Isle of Man legislation, like the UK legislation, does not include an economic benefit criterion, though the FSC's mission statement does refer to this.

- *Minimum criteria for licensing*. The Jersey legislation does not set out any minimum registration criteria. In practical terms, the omission is not important. There may however be a case for including such criteria when the legislation is next updated.

- *"Managed" banks*. In all the Islands the authorities are willing to license "managed" banks. Such banks usually have no separate physical presence on the Islands but are managed by Island banks and use their staff. The parent banks of managed banks are able in this way to have a cost-effective presence on the Islands, to extend their offshore product range and, in some cases, to gauge whether a fuller presence would be beneficial. The licensing requirements for managed banks include approval of the local manager and the management agreement and confirmation from the bank's auditors that books and records are maintained locally. Otherwise, supervision is the same as for other banks. For subsidiaries, the authorities insist on meeting the responsible Director from the parent bank once a year.

- *Licence conditions and categories*. The authorities in all the Islands require letters of comfort from parent banks about the activities of subsidiaries. They have discretion to attach conditions to the issue of licences. The Jersey and Guernsey authorities follow UK practice in treating such conditions as a private prudential matter. The Isle of Man authorities use these conditions and differentiated licence categories publicly to restrict the scope of individual banks' businesses. The Isle of Man also has a wider definition of banks.

- *Annual licence renewal*. The Jersey and Isle of Man authorities require annual license renewals but are considering whether to discontinue this requirement.

### 7.9 On-going supervision policy

7.9.1 The Island authorities have followed the traditional UK approach to on-going supervision, based on off-site analysis of monthly and quarterly prudential and statistical returns (now beginning to be electronically reported in all the Islands) and prudential meetings, once or twice each year, with the banks' senior managements.

7.9.2 In all the Islands, the FSCs have established close links with the banks' *auditors*, both internal and external. This seems to me another considerable source of strength.

7.9.3 Auditing of banks is a specialist task. The internal auditors in the Islands mostly come from parent banks. External auditors are subject to approval by the FSCs. They have an obligation to whistle-blow to the FSCs and serve in practice as reporting accountants for them. For the most part, the FSCs undertake on-site inspections themselves, with their own staff, but they also commission reports from reporting accountants from time to time.

7.9.4 As in other jurisdictions, the FSCs look at the *related businesses* of individual banks, such as asset management, custody, Trust and company business, so as to assess what implications there may be for the bank's overall position. For many of these related activities, there has in the past been no conduct of business regulation. As explained in Chapters 12 and 13, however, the Island authorities have proposals to extend the regulatory boundary into these areas.

### 7.10 Particular issues on supervision

7.10.1 Some particular issues on supervision which Mr Sutherland has identified are:

- *On-site inspections*. Such inspections form a key component in the Basle Committee's Core Principles, which are due to become formal policy from October 1998. In all the Islands, the FSCs have made a start on them. But they do not yet have a full programme in place. There is no on-going programme for on-site assessment of banks' management quality, internal controls and procedures. The FSCs do not at present have the staff to implement such a programme. They all recognise, however, that they will need to tackle this area promptly, with help as necessary from reporting accountants, if full compliance with the Basle Committee principles is to be achieved.

- *Risk assessment profiles and capital adequacy*. Supervision needs to be more closely based on risk assessments for individual banks. Risk profiles are not yet well developed. In all the Islands, the minimum capital requirement for subsidiaries is 10 per cent, compared with the Basle Committee's minimum requirement of 8 per cent, and actual capital levels are well in excess of this. Only in Guernsey, however, is there risk-based differentiation in capital requirements across the board. In all the Islands, as elsewhere, parent banks are held responsible for the capital backing of branches.

- *Risk concentrations*. In all the Islands (apart from a small anomaly in Guernsey), banks have to obtain the FSC's permission before taking on individual risk exposures above 25 per cent of capital (other than short-term exposures to parent or other banks). Aggregate large exposures are limited to 800 per cent of capital.

- *Parent bank exposures*. Exposures to parent banks are, not surprisingly, a particular area of difficulty in centres, such as the Islands, where subsidiaries often act as deposit-gatherers for parent banks. If the parent bank goes bust, customers who have deposited money with the subsidiaries may be vulnerable. Except in the Isle of Man, they will not have access to a depositor protection scheme. The FSCs try to set some limits on such exposures. Mr Sutherland has suggested that there may also be scope for limiting these risks through collateralisation, such as asset sale and repurchase arrangements.

  These risks need of course to be kept in perspective. Apart from the absence in Jersey and Guernsey of depositor protection schemes, the risks to depositors will not normally be greater than the risks to those depositing money with the parent banks, which are mostly major world banks.

- *Liquidity requirements*. Host supervisors are responsible for monitoring local liquidity, both for subsidiaries and for branches. Rightly, therefore, the FSCs in all the Islands obtain full maturity analyses of assets and liabilities for each bank.

  In Guernsey and the Isle of Man, the authorities monitor liquidity on the standard UK basis, with measurement of mismatch over defined periods. In Jersey the monitoring is less structured.

  The Guernsey authorities apply standard guidelines and limits, including a maximum 20 per cent guideline for the cumulative negative mismatch to one month before allowing for marketable assets. The Jersey and Isle of Man authorities have so far been less prescriptive but are developing more proactive approaches.

### 7.11 Lessons from recent cases

7.11.1 The Island authorities have had in recent years to deal with a few difficult cases. The case histories may offer useful lessons for the future. Chapter 15 considers some possible lessons for criminal prosecutions. This section considers some possible lessons for the development of licensing and regulation in the Islands.

*(a) Bank Cantrade in Jersey*

7.11.2 Chapter 17 of the Jersey section describes the recent case involving Bank Cantrade (a UBS subsidiary), a foreign currency trader and his accountant.

7.11.3 The trader:

solicited funds from investors for foreign currency trading, initially in 1988;

placed them with Bank Cantrade in Jersey;

made foreign currency transactions from which both he and the bank earned significant commissions; and

lost about $11 million;

but misled investors by falsifying the accounts to indicate profits of some $15 million.

7.11.4 A partner from Touche Ross in England certified the false accounts. Representatives of the bank, too, made statements as to the trading performance of the fund which were later judged to be criminally reckless.

7.11.5 The Jersey Finance and Economics Committee received a customer complaint early in 1994. The Jersey police investigated the complaint. The Committee decided not to make its own investigation, partly because the case seemed to be concerned with conduct of business matters rather than prudential concerns and partly because a criminal investigation was already under way. The Committee did, however, commission a report from Coopers and Lybrand, the bank's auditors. The Island's prosecuting authorities brought prosecutions in 1995 against the bank, a member of the bank's staff, the dealer and the accountant.

7.11.6 In June 1996, new material was put before the Finance and Economics Committee concerning prudential issues which, it appeared to the Committee, the criminal investigation might not cover.

7.11.7 The Committee therefore decided to exercise its powers under Article 27 of the Banking Law to obtain a report by independent accountants covering all aspects of the bank's treasury operation. A report by Arthur Andersen was produced, assessed, acted upon and followed through to a conclusion satisfactory to the Committee.

7.11.8 In order not to prejudice the criminal investigation and due to the sensitive nature of the matter, the Committee did not make this investigation public at the time.

7.11.9 At the trial in 1998,

the bank pleaded guilty to recklessly making false statements and was fined 3 million;

charges against the individual bank employee were dropped;

the trader was found guilty and sentenced to 4 1/2 years in prison; and

the accountant was found guilty and sentenced to 1 1/2 years in prison.

7.11.10 With regard to regulatory aspects (Chapter 15 discusses the criminal aspects), the case seems to me to confirm how right the Jersey authorities have been to develop their regulatory structures, policies and practices in the way they have in the past year or two. Three key developments in this connection are:

- *Establishment of an independent FSC*. An independent Financial Services Commission, if it had existed at the time, would have been more likely to launch straight away, in 1993, a full investigation of the regulatory implications of the case. In my opinion, the F&E Committee's decision not to launch such an investigation in 1993 was understandable in view of the police investigation, the commissioning of the auditor's report and the reluctance of banking supervisors, even as recently as 1993, to address conduct of business as against prudential issues. It is often difficult in any case to assess straight away the wider significance of customer complaints. With the wisdom of hindsight, however, it would arguably have been better to mount a full investigation of the regulatory implications straight away and act on them sooner.

- *Investment business Law*. With implementation of the new Investment Business Law, the trader's activities (though not the particular investment scheme) would now be subject to licensing. A trader offering investors the assurance of high returns on a manifestly speculative investment would be unlikely to be licensed. As it was, the trader's activities and the investment scheme were at no time subject to licensing or regulation. It is surprising, even so, that they slipped through the net. For the Jersey authorities have made a point of rigorous vetting of new financial

businesses through powers available under the Regulation of Undertakings and Development Law and the housing permits legislation. The authorities' own view is that they relied too heavily on the reputation of the promoting bank and the assurances it gave.

- *On-site inspections*. With the development of on-site inspections and management quality assessments on the lines discussed earlier in this Chapter, the regulators would now be better placed to pick up deficiencies of management and competence of the kind that seem to have occurred inside the bank. As it was, the regulators were not well placed to discover that some of the bank staff concerned were acting (as it appears) well outside their competence and without any adequate supervision.

7.11.11 Some further reflections prompted by this case are:

- *Reliance on a size criterion*. Sensible and re-assuring as a licensing policy based on admitting only the world's top 500 banks by capital size may be, it cannot be assumed that there will be no regulatory problems with subsidiaries of such banks especially where conduct of business is concerned. As discussed above, the Island authorities are keenly aware of this point.

- *Island Rules of Business Conduct*. As discussed in Chapter 6, there is a case for developing Island Rules or Codes of Business Conduct for bankers and those involved in investment and insurance business.

  In the Cantrade case, it appears that the financial arrangements between the trader and the bank were such as to give both parties an incentive to multiply or "churn" transactions, without regard to the interests of investors, even though the forensic accountants did not find evidence that churning had in fact occurred. Regulatory authorities, not just in the Islands, have traditionally seen such "conduct of business" issues as being not for them but for bankers and other professional associations to develop for themselves through voluntary Codes of Conduct. They have traditionally limited themselves to "prudential" supervision, designed to ensure that risks are well managed at an aggregate level and the dangers of insolvency are consequently minimised. In the UK, there are conduct of business rules and codes which (among other things) prohibit "churning". The authorities in all the Islands will do well, in my opinion, to develop similar rules or codes, drawing on UK and other models, where they have not done so already, and to ensure that they apply wherever relevant throughout the finance sector. Chapter 6 includes a wider discussion.

- *Whistleblowing*. The FSCs in the Islands, like the SEC in the US, might do well to set up a confidential reporting line for regulatory breaches and crimes. A member of Bank Cantrade's staff has said in a recent article that he expressed concern to the bank's management's on several occasions about matters that later became the subject of the recent case. But the management took no action, and his career visibly suffered. If this is true (and I have no reason to think otherwise), it is clearly a cause for concern.

*(b) Barings and another case in Guernsey*

7.11.12 When *Barings Bank* failed in 1995, the bank's Guernsey subsidiary had lent deposits well in excess of its capital base to the parent bank and was therefore technically insolvent. As explained in the Island section, the Guernsey FSC did all it could to prevent the bank from going into liquidation so that a buyer might be found and the depositors might be protected. In this the FSC was successful. It had, however, to take a calculated risk in not immediately declaring the Guernsey subsidiary insolvent even though there was no very clear legal basis for allowing it to continue in business.

7.11.13 Mr Sutherland and Mr Sears have suggested that the Guernsey authorities should consider introducing some form of rescue, moratorium or administration procedures, as in the UK, to help in dealing with such situations. As discussed in Chapter 10, the authorities in all the Islands are considering this. The Jersey authorities have already issued a draft law for consultation.

7.11.14 In another case, also referred to in the Island section, the Guernsey authorities prosecuted the managing director of a local institution who fraudulently induced investors to invest monies on deposit and later failed to repay them. The person concerned was convicted and received a one-year custodial sentence and a 28,000 fine. Many depositors appear, however, to have lost all or most of their money.

7.11.15 In my opinion, this episode supports the case for having in the Islands' FSCs pro-active and well-resourced

enforcement units, with effective powers to police the "perimeter" of unlicensed business and to take the profits out of crime through the use of civil procedures. Chapters 6 and 14 develop these themes.

*(c) BCCI in the Isle of Man*

7.11.16 BCCI had a branch in the Isle of Man. This was wound up in 1991 along with BCCI's other operations. The two-thirds of customers who applied for compensation under the Island's Depositors' Compensation scheme (see Chapters 2 and 6) have received up to 15,000 each. Payments under the scheme are financed at the time by levies on other local banks subject to an upper limit in any one year. The BCCI payouts have required over three years' worth of levies, though significant refunds are now being made as payments are received from the liquidator.

7.11.17 The BCCI saga clearly underlines the importance of initial vetting for licences. A local branch, even if well managed and regulated (as the Isle of Man branch appears to have been), is at risk of being dragged down by dishonesty, corruption or mismanagement in the wider group.

7.11.18 As noted in the Island section, the Depositors' Compensation Scheme has enabled the Isle of Man authorities to respond responsibly and sympathetically to the interests of depositors. Without the scheme, such a response would not have been possible except at heavy cost to the public purse (as happened in the Savings and Investment Bank failure of 1982).

7.11.19 At a practical level, the case has shown that implementing such schemes is a heavy task. It has also highlighted the problem that if a larger bank should become insolvent many years of levies could be needed to finance the compensation.

*(d) Conduct of business cases*

7.11.20 Aggrieved customers wrote to me about other cases involving banks and / or investment funds in the Islands. In all cases, the customers were dismayed that the Islands' FSCs, while becoming involved to a limited extent, had declined to intervene in a decisive way.

7.11.21 As discussed in Chapter 6, I believe that a Financial Services Ombudsman might well have been able to promote solutions (not always, of course, in the customer's favour) in some at least of these cases. In the meantime, the Islands' FSCs have told me that they do already play a conciliating role in some such cases, often with considerable success.

**7.12 Resources**

7.12.1 The introduction of on-site inspections, as called for in the Basle Committee's core principles, will require extra resources for banking supervision in the Islands. The banking supervisors already seem heavily stretched or in some cases over-stretched.

7.12.2 The scale of the requirement is more debatable. Some indicators of comparative pressure are included at the end of the Box 7.1 table.

7.12.3 Based on these and other indications, it looks to me as if the Jersey and Isle of Man banking supervisor teams may each need an extra two professional staff and the Guernsey team an extra one.

7.12.4 In the meantime, the Islands' banking supervisors will need to rely more heavily than now on the use of reporting accountants.

**BOX 7.1-Banking Business and Supervision**

*Latest available dates*

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| *Number of licensed banks* | | | | |
| Total | | 79 | 76 | 70* |
| Of which: | | | | |
| Subsidiaries | | 42 | 34 | 41 |
| Branches | | 25 | 14 | 20* |
| "Managed" banks | | 12 | 28 | 9 |
| Home supervisor responsibilities | | 8 | | 3 |
| *Scale of business*** | | | | |
| Total liabilities, bn | | 110.9 | 55.0 | 22.3 |
| Deposits | | | | |
| Total, bn | | 99.8 | 49.8 | 20.0 |
| Average per bank, bn | | 1.26 | 0.66 | 0.29 |
| deposits: | | | | |
| Total, bn | | 32 | 17.8 | 13.7 |
| Proportion of total deposits, % | | 32% | 36% | 68% |
| UK resident deposits: | | | | |
| Total, bn 19.4 7.4 5.3 | | | | |
| Proportion of total deposits, % | | 19.4% | 14.9% | 26.5% |
| Assets invested in UK: | | | | |
| Total, bn | | 53.6 | 18.7 | 12.2 |
| Proportion of total liabilities, % | | 48% | 34% | 55% |
| *Staff* | | | | |
| Bank staff | | 4,700 | 2,688 | 1,781 |
| Regulator staff, FTEs | | 5 | 5 | 3 |
| *Supervision ratios (per regulator staff member)* | | | | |
| Deposits, bn | 7/16 | 20 | 10 | 6.7 |
| Banks | 1/16 | 16 | 15 | 23 |
| Bank staff | 15/16 | 940 | 538 | 594 |

* *Includes 3 branches of UK building societies.*
** *Scale of business figures are for June 1998.*

# 8 INVESTMENT AND SECURITIES BUSINESS

### 8.1 Introduction

8.1.1 This Chapter draws heavily on a review of the regulation of investment and securities business in the Islands commissioned by the Home Office at my request from Mr Guy Sears. I am most grateful to Mr Sears.

### 8.2 Types of business

8.2.1 In all the Islands, the investment business consists mainly, but by no means exclusively, of the management, administration and custody of collective investment schemes. These schemes include:

- *"recognised" open-ended schemes*, including unit trusts, which the Island industries are permitted because of their "designated territory" status to market to the general public in the UK and in practice in certain other countries as well. These schemes are broadly equivalent to schemes that qualify under the EU Directives on Undertakings for Collective Investment in Transferable Securities (UCITS), which govern the establishment of collective investment schemes and their marketing to the public;

- *other open-ended retail schemes*, likewise broadly equivalent to schemes qualifying under the EU's UCITS Directives, which can be sold to investors and through intermediaries in certain other countries other than the UK;

- *professional investor open-ended schemes*, designed for institutions and professional investors. These are not subject to the prescriptive regulatory regimes for "recognised" funds or for other schemes similar to UCITS schemes and are not permitted to be marketed to the general public; and (except in the Isle of Man)

- *closed-ended investment schemes*, including investment trusts, where the total amount invested is limited by share issues or other means.

8.2.2 The Treasury in London has granted *"designated territory"* status to all three Islands. This enables the Islands' industries to market their "recognised" open-ended investment schemes to the general public in the UK. Before granting this status, the Treasury has to satisfy itself that the jurisdiction in question has a standard of regulation for the schemes concerned equivalent to that of the UK.

8.2.3 The grant of designated territory status has helped the industries in all the Islands to market their schemes more widely as well. They can market schemes to the general public in a range of countries, including Japan, Ireland, Hong Kong, Australia, the Netherlands and Switzerland.

8.2.4 The Islands also host schemes sponsored by international managers from some 40 countries.

8.2.5 In addition to the collective investment schemes listed above, the Jersey industry has made a speciality of *debt-issues* and *securitisation* programmes as well.

8.2.6 Apart from collective investment schemes and debt issues, the main investment businesses are:

- *investment managers*, on a discretionary or non-discretionary basis;

- *investment advisers*; and

- *stockbrokers*.

### 8.3 Scale and distribution of business

8.3.1 The accompanying Box 8.1 gives some indication of the scale of these businesses. The figures are collected on different bases in each Island and should therefore be interpreted with caution.

8.3.2 For collective investment schemes, the Jersey authorities estimate that the total amounts invested may be around 35 billion in around 1100 schemes with one or more Jersey functionaries (an average scheme size of 32 million). The Guernsey authorities estimate total amounts invested of around one-half of the Jersey figure and the Isle of Man around one-seventh (calculated on a more restricted basis).

8.3.3 In Guernsey, open-ended "professional investor" schemes have been the main growth area. "Recognised" open-ended schemes account for only 20 per cent.

8.3.4 The Guernsey authorities estimate that only around 13 per cent of the funds invested come from the UK.

### 8.4 Tax status

8.4.1 For the most part, collective investment schemes are constituted in the Islands as tax exempt companies (see Chapter 10). No tax is deducted from dividends or interest paid to non-residents. In the Isle of Man, some schemes are treated as "approved investment companies". Here, too, distributions to non-residents are paid gross.

### 8.5 Licensing and Regulatory policy

8.5.1 As in the UK, the authorities in all three Islands have a policy to ensure that the regulation of investment business reaches the highest international standards. All are members of the International Organisation of Securities Commissions, IOSCO, and play a full part in its activities.

8.5.2 The legislation and the licensing and regulatory regimes are broadly along UK lines, though with some differences.

### 8.6 Legislation and Codes of Conduct

8.6.1 All the Islands now have legislation and supporting rules or Codes in place to license and regulate investment business. Some similarities and differences compared with the UK legislation and systems are discussed below.

8.6.2 The Isle of Man introduced a comprehensive Investment Business Act ahead of the other Islands, in 1991. Based on the UK's Financial Services Act 1986, this provides for the licensing and regulation of all investment business, both collective investment schemes and other categories.

8.6.3 The Jersey and Guernsey authorities initially licensed and regulated only collective investment schemes. Licensing and regulation of these schemes on UK lines were needed to give the Island industries access to the UK market.

8.6.4 Guernsey introduced a Protection of Investors Law for this purpose in 1987. Jersey followed in 1988 with a Collective Investment Funds Law.

8.6.5 In both Islands, however, the authorities have also continued to use their powers under long-established Control of Borrowing Orders to control what investment businesses may be established on the Islands. Significant numbers of applications are refused.

8.6.6 This year the Jersey and Guernsey authorities have brought forward legislation to extend licensing and regulation to forms of investment business other than collective investment schemes. In Jersey this has taken the form of a new Investment Business Law. The Guernsey authorities have extended and updated their earlier Protection of Investors Law.

8.6.7 Guernsey has supporting Rules for investment business. The Isle of Man has Codes of Conduct with the status of

Rules. In both cases, the FSCs have power to enforce them.

8.6.8 In Jersey, the Codes will not be similarly enforceable but will be usable in Court as evidence of best practice. As in other centres, the Jersey FSC will be able to give directions based on elements in the Codes and will be able to take compliance with the Codes into account for licensing purposes, including revocation of licences.

8.6.9 In the opinion of Mr Sears and myself, rules of investment business, or enforceable codes, are preferable to codes which may be the subject of directions. There should be no doubt that failure to comply with the basic rules or codes will be treated as a breach of regulation. We hope, therefore, that the Jersey authorities will consider adopting this approach. In the meantime, we hope that the FSC's disciplinary policies (including licensing conditions) may be such as to deliver the same effect in practice.

### 8.7 Licensing of schemes and scheme providers

8.7.1 With regard to collective investment schemes, the Island authorities selectively license and regulate the *institutions* providing such schemes. The licence criteria include the usual "fit and proper" elements of integrity, competence, solvency, financial backing and track record.

8.7.2 The Island authorities also issue permits in many cases for individual schemes:

- For *retail* schemes, including schemes "recognised" by the UK authorities, the requirement is universal. The "recognised" schemes have to meet UK-style requirements in terms of marketing, management and permitted investments.

- For *schemes aimed at professional investors, closed-ended schemes and debt issues*, the licensing and regulatory details vary between the Islands. In all cases, however, the requirements are lighter and less prescriptive.

8.7.3 It seems entirely reasonable to differentiate in this way between schemes sold to the general public and vehicles for use only by professionals.

### 8.8 Licensing of other activities and providers

8.8.1 With two main exceptions noted below, the Island authorities now have comprehensive regimes similar to the UK's for licensing and regulation of other investment activities:

dealing,
arranging deals,
management of funds (discretionary and non-discretionary), and
investment advice.

In one respect, indeed, their coverage goes wider than the UK's. Institutions conducting such activities in *or from* the Islands are subject to licensing and regulation.

8.8.2 The main exceptions are:

- In Jersey, the licensing and regulation requirements do not extend to *arranging deals*. Various categories of unusual deals are consequently likely to be excluded, as are certain categories of intermediary. In the opinion of Mr Sears and myself, the powers would preferably be defined so as to cover *any* category of activity where the regulators may need to intervene. It also seems better not to omit from the regulatory zone a category of activity included in other similar regulatory frameworks elsewhere.

- In Guernsey, *long-term insurance products* are not counted as investments and are not, therefore, subject to conduct of investment business regulation although they are, of course, subject to conduct of insurance business regulation.

- In the Isle of Man, similarly, *long-term insurance products* are not subject to conduct of investment business regulation if sold by the insurance company's own staff. The same products are, however, subject to this regulation

if sold by independent financial advisers. Such products should clearly be subject to conduct of business regulation regardless of who sells them. The Island authorities have been working up proposals accordingly.

I hope that the authorities in each of the Islands will take an early opportunity to make good these lacunas.

8.8.3 The Isle of Man authorities follow the UK practice in *exempting* from the licensing requirement lawyers and accountants whose professional institutions have authorised them to carry out such business. In my opinion, this is defensible. But there is a strong case for requiring all providers of such services to register, as is proposed for company and Trust services providers.

### 8.9 Client accounts and custodial services

8.9.1 The Island authorities generally follow best practice in the segregation of client assets and accounts. Mr Sears has, however, noted two areas where, for the time being at least, the position is formally not as clear as it might be:

- In Guernsey, the rules made under the Investment Business Law do not explicitly declare that client account assets held by a firm in the name of a client are held in Trust and cannot therefore be treated as available assets in the event of the firm's insolvency. The authorities have noted that this matter can be dealt with when the rules are reviewed. Meanwhile, they believe that the Island's Trust Law framework covers the position adequately.

- In Jersey, the Investment Business Law does not include custody as a regulated activity but the authorities intend that the forthcoming Fiduciary and Administration Business Law should do so.

### 8.10 On-going supervision

8.10.1 All the Island FSCs have good programmes for on-going supervision, including regular returns of information to the FSC and on-site inspections. There are however some gaps in powers and the supervisors are heavily stretched. In Jersey and Guernsey, the regimes for investment business other than collective investment schemes are in their infancy.

*(a) On-site visits*

8.10.2 In all the Islands, Mr Sears found good programmes for regular on-site inspections of collective investment schemes, their managers, trustees and custodians.

8.10.3 In my opinion, effective supervision of investment business areas other than the schemes will require relatively frequent on-site inspections, especially in the early years. The Jersey and Guernsey authorities, in particular, may need to have this in mind as they implement this extension of the regulatory boundary.

8.10.4 With regard to existing programmes some points which arose were:

- Apart from "recognised" schemes, which are inspected annually, full-scale inspections have been less frequent than the authorities would wish. Some firms are visited only once every three years. The authorities have tried to mitigate the problem by short focused visits concentrated on riskier areas.

- In Jersey and Guernsey, the inspectors make a point of visiting junior staff as well as managers since these staff, too, are a source of risk.

- In all the Islands, but especially Jersey and Guernsey, out-sourcing of back-office tasks is increasingly common as pressures mount on the Islands' scarce resources. This is an issue for supervision. The solution may lie in co-operation with regulators or suitably qualified auditors in the jurisdictions where the back-office work is done.

*(b) Whistle-blowing by auditors*

8.10.5 In all the Islands, the auditors are required to "whistle-blow" to the FSCs and cannot be sued for breach of

confidence.

*(c) Powers to investigate*

8.10.6 The legislation gives the Island authorities wide powers to investigate licensed or previously licensed firms:

- In the Isle of Man these powers are very similar to those in the UK.
- In Jersey, too, normal inspection powers can be exercised without advance warning. Where unauthorised business or misleading statements are suspected, the Bailiff may authorise a requirement for immediate compliance, including entry and search warrants.
- In Guernsey, the powers are similar except that there is no power to search and seize and no offence of failing to answer. The Police and Customs do of course have wide-ranging powers where criminal conduct is suspected. But these do not extend to non-criminal breaches of regulation, which may be serious in themselves and which the regulators may need to inspect thoroughly. There will be an opportunity to add these powers when the Law is amended to reflect the European Court of Human Rights judgment on self-incrimination in the Saunders case.

*(d) Powers to enforce*

8.10.7 The Isle of Man has the most complete set of enforcement powers, matching those in the UK. These include powers to:

- revoke licences
- give directions or impose conditions
- name and shame licensed persons who have committed misconduct
- debar individuals from holding particular posts or stakes
- seek injunctions against misleading statements
- seek injunctions and restitution for breach of conditions, regulations or regulatory codes
- seek injunctions and restitution for unauthorised business
- vest the investors' assets in a trustee
- wind up or bankrupt persons in the public interest.

8.10.8 The Jersey authorities' powers, though similar, do not include powers to:

- apply for restitution for investors who previously suffered loss in cases not involving collective investment scheme, or
- seek injunctions and restitution for breach of regulatory codes. Although there are powers, as elsewhere, to give a direction after breach of a Code, directions are not equivalent to Court injunctions.

8.10.8 The Guernsey authorities' powers are formulated somewhat differently but have the same effect except that they do not include the powers to:

- name and shame,
- seek injunctions against misleading statements (though as in other jurisdictions the publication of misleading statements is a criminal offence and Directors are liable to pay compensation for false or misleading prospectuses), or

- ban individuals from being employed in the industry at all (though as elsewhere there are powers under company law to ban persons from being Directors of companies).

8.10.9 The authorities in both Islands may wish to consider taking an early opportunity to add these powers to their otherwise highly effective arsenals.

*(e) Policing the perimeter*

8.10.10 The prevention and combating of unlicensed business are especially important in the investment business area, as they will be also in the area of Trust and company services providers.

8.10.11 For the Isle of Man's FSC, policing the "perimeter" of unauthorised business is a core function. The FSC's Enforcement Unit acts, in Mr Sears's phrase, as a kind of "Civil Fraud Office" for the Island's International Finance Centre.

8.10.12 The Jersey and Guernsey FSCs have not in the past consolidated in one place the lead-responsibility for policing the perimeter. For all the reasons discussed in Chapter 6, they would in my opinion be well-advised to consider this seriously and to make it an explicit part of their core function.

8.10.13 Within the broad area of investment business, there are various kinds of perimeter activity, often not falling neatly into any of the main areas of supervision, which the police cannot investigate. The FSCs need to identify and pursue such activities. Without dedicated expert units, they will not be well placed to do so. Such units also have an invaluable role to play in international co-operation (see Chapter 6).

**8.11 Insider trading**

8.11.1 Insider trading is an area where overseas regulators often need co-operation. Although not prosecuting authorities for insider dealing offences, the FSCs in Jersey and the Isle of Man can appoint investigators or inspectors. In Guernsey, the law officers can appoint inspectors. There are also powers to obtain search warrants. HM Procureur is able to make ex parte application to the Bailiff to send material to a relevant authority.

8.11.2 The Jersey authorities are preparing a new Insider Dealing Law. A key requirement will be to draw the definition of securities violation and fraud as widely as possible so as to ensure that co-operation can be given.

8.11.3 In Guernsey, offences under the Law should preferably include, as in the UK, Jersey and the Isle of Man, creating false markets in securities.

**8.12 Channel Islands Stock Exchange**

8.12.1 The Guernsey FSC has announced plans for the introduction later this year of a Channel Islands Stock Exchange (CISE) based in St Peter Port, Guernsey. This will be the first Exchange in the Crown Dependencies. The Cayman authorities introduced such an Exchange last year. Bermuda has had one for some years. The Dublin International Financial Services Centre and Luxembourg likewise have Exchanges.

8.12.2 The Guernsey authorities see the Exchange as bringing economic and one-stop-shop benefits to the Channel Islands, primarily through provision of:

- trading and listing facilities for collective investment funds and debt instruments;
- primary and secondary listings of securities and shares issued by Channel Islands companies; and
- secondary listings of securities and shares issued by overseas companies.

8.12.3 As explained in the Island section, the CISE has been formed as a company limited both by guarantee and by shares. Management and control will be vested in an elected Board.

8.12.4 The new Exchange looks to have the potential to increase the attractions of the Islands as a centre for new investment business as well as generating some fee income which would otherwise have gone abroad. Some factors in its favour will be:

- For collective investment funds, a Stock Exchange listing is a powerful marketing tool. Fiduciary investors, for example, are commonly limited to quoted shares. Many of the Islands' existing funds are listed accordingly on the London Stock Exchange or other Exchanges.

- Both for collective investment funds and for other instruments, Stock Exchange listings offer the prospect of liquidity advantages and the reassurance of "best execution" prices.

- The new Exchange should be well placed to offer a generally favourable costs and fiscal regime, enabling it to compete effectively with other smaller Exchanges in particular, such as Luxembourg and the Irish International Financial Services Centre.

8.12.5 Supervision of a Stock Exchange is by no means a simple task. There will be major issues for the CISE Company itself to resolve on issues such as indicative prices, liquidity, the role of intermediaries and insider trading. These will need to be incorporated in an initial book of ground rules and practices.

8.12.6 For the Guernsey FSC, too, there will be important issues not just in overseeing the framework proposed by the CISE Company but also in determining the relative roles and responsibilities of the FSC itself, the CISE Company and the criminal authorities. The FSC will need to ensure that it has the necessary expertise to regulate the Exchange the CISE Company successfully from launch onwards. The CISE Company, similarly, will need to be prepared to regulate its members.

8.12.7 With these points in mind, I hope that the FSC and the Company will give priority to thorough preparation in advance rather than an early launch.

### 8.13 Resources

8.13.1 As discussed earlier, there are significant pressures on investment supervision resources in all the Islands' FSCs. My assessment would be that:

- The Isle of Man FSC is understaffed in this area. Between two and three more professional people are needed.

- The Jersey FSC probably needs one extra person, not least to develop and deepen the Jersey FSC's approach to investment regulation and to tackle the various issues on legislation, codes, perimeter policing and international co-operation discussed in earlier sections.

- The Guernsey FSC, too, would appear to need an extra one professional staff member, partly to reinforce the investment supervision team but also to oversee the new Stock Exchange.

**BOX 8.1-Investment Business and Supervision**

*Latest dates for which complete information is available*

| | | Jersey | Guernsey | Isle of Man |
|---|---|---|---|---|
| *Numbers of Funds / Providers* | | | | |
| Investment fund managers | | 25 | 17 | 22 |
| Funds | | 335 | 381 | 102 |
| Separate investment pools / schemes | | 1100 | 717 | na |
| Investment advisory businesses | | 50 | 65 | 30 |
| Stockbroker businesses | | 12 | 7 | 8 |
| Other | | na | na | 30 |
| *Scale of Funds business* | | | | |
| Amounts invested, £ bn | | 35.3 | 16.0 | 6.1 |
| Of which: | | | | |
| Open-ended schemes | | | | |
| UK "recognised" | | 3.4 | 3.3 | 1 |
| Other retail | | 26.6 | 3.9 | 5.1 |
| Professional and institutions | | | 3.8 | |
| Closed-ended schemes | | 5.3 | 5.0 | — |
| Proportion of investments from UK | | na | 13 % | na |
| *Staff in the industry* | | 1,500* | 1,394 | 1,229 |
| *Investment Staff in the FSCs* | | | | |
| Total | | 15 | 11 | 6 |
| Of which: | | | | |
| Schemes | | 11 | 8 | 3 |
| Other | | 4 | 3 | 3 |
| *Supervision ratios (per scheme regulator staff member)* | | | | |
| Value of schemes, £ bn | 7/15 | 3.3 | 2.0 | 2.0 |
| Number of Schemes | 3/15 | 100 | 90 | na |
| *(per regulator staff member)* | | | | |
| Investment staff in the industry | 13/14 | 100 | 127 | 205 |

**Estimate*

# 9 INSURANCE AND PENSIONS BUSINESS

## 9.1 Introduction

9.1.1 This Chapter draws on a review of insurance regulation in the Islands commissioned by the Home Office at my request from a former insurance supervisor to whom I am most grateful.

## 9.2 Scale, type and distribution of business

9.2.1 As indicated in the Box 9.1 table, Guernsey and the Isle of Man both have large offshore insurance sectors, mainly providing captive insurance facilities and life insurance products to non-resident customers, as well as domestic insurance sectors.

9.2.2 On captive and commercial insurance, Guernsey leads with some 344 companies, assets of 5.2 billion and gross annual premium income of some 1.6 billion. The Isle of Man has 177 companies, assets of 4.7 billion and gross premium income of 1.0 billion.

9.2.3 The principal owners of captives are large companies, mostly UK companies or multinationals, wishing to undertake some of their own insurance risk as a cost-effective means of handling their total risks. Guernsey has also developed new forms of vehicles for financial guarantee business and protected cell companies (see below).

9.2.4 On life insurance, the Isle of Man leads with some 15 active companies, gross annual premium income of 2.1 billion and assets of 7.6 billion. Guernsey has 10 life companies, gross annual premium income of 561 million and assets of 2.2 billion.

9.2.5 In both the Islands the parent companies for life insurance business used mostly to be based in the UK or other European centres and to serve mainly UK or other expatriate customers. But ownership and customers are now more diverse. Guernsey companies do not market into the UK.

9.2.6 Guernsey also hosts about 220 offshore pension funds, which are exempt under the Income Tax Law. These are mainly established by multinational companies for internationally mobile staff.

9.2.7 In contrast with the banking and investment sectors, the commercial and captive insurance business in Guernsey and the Isle of Man is still heavily oriented towards UK companies and clients. In Guernsey, for example, about three-quarters of the companies have UK parents. UK policyholders, predominantly corporate, account for about 60 per cent of the premium income. The UK share is declining, however, as increasing numbers of customers are attracted from elsewhere. The life insurance business is more widely spread.

9.2.8 Jersey has only recently begun to compete for insurance and pensions business and has only a small sector, comprising 10 captives and commercial companies and 3 life funds.

9.2.9 All three Islands have designated territory status under section 130 of the UK's Financial Services Act, 1986. This enables their life insurance companies who are members of the UK's Personal Investment Authority to market their products in and through the UK.

## 9.3 Management companies

9.3.1 In both Guernsey and the Isle of Man specialist insurance management companies, mostly owned or associated with international insurers, brokers or consultants but also including some independents, manage most of the commercial and captive offshore insurers. Guernsey has 37 such companies. The Isle of Man has 35.

9.3.2 In Guernsey, all insurance companies and funds are required to identify a general representative, who is usually the same person or institution as the insurance manager. The Isle of Man similarly requires every insurer to have local management or to appoint a registered insurance manager.

9.3.3 The specialist skills and low cost base of these management companies have helped to make offshore captive insurance attractive for medium-size as well as large companies.

### 9.4 Tax status

9.4.1 The Islands' locally registered insurance companies mostly choose to be constituted as tax exempt companies but some choose to be international business or tax resident companies (see Chapter 10). The choice depends on the nationality and tax circumstances of the parent group.

9.4.2 For the most part, insurance companies in the Islands writing non-Island business can obtain tax advantages relative to onshore companies conducting similar business, though the extent of these depends on the tax regimes in the parent jurisdictions. Captives with UK parents now have few tax advantages.

### 9.5 Regulatory objectives

9.5.5 In all the Islands the authorities have similar aspirations for the regulation of offshore insurance business. Although expressed somewhat differently in each Island, the four key objectives are:

- to protect policyholders and investors through effective licensing and supervision designed to ensure solvency and good conduct of business;
- to support the development of successful insurance sectors bringing economic benefits to the Islands;
- to prevent and deter the use of insurance vehicles for money laundering and other forms of financial crime; and by all these means
- to protect and enhance the reputations of the Islands as international finance centres.

9.5.6 The regulatory regimes consist mainly in licensing requirements, on-going supervision and powers of investigation and enforcement.

### 9.6 Modalities of regulation

9.6.1 In both Guernsey and the Isle of Man, the emphasis of regulation remains firmly on the insurance companies themselves and their Directors. The companies are legally obliged to conduct insurance business in accordance with their licence applications, updated as necessary, including the business plan (which mainly consists of the detailed insurance and re-insurance programmes).

9.6.2 On a day to day basis, however, the authorities implement the regulatory regime mainly through the general representatives or local insurance managers described in section 9.3. The regulators have regular contact with the managers. The Guernsey FSC requires prior notification of material changes to the insurance and reinsurance programmes.

### 9.7 Policy issues

9.7.1 There are four major issues which insurance regulators in the Islands, as in other finance centres, have to address on a

continuing basis.

*(a) Supervision versus economic development*

9.7.2 In the Islands, as elsewhere, insurance regulators have tended to play a more critical part than banking or investment regulators in supporting the industry's progress and, especially in Guernsey, in the development of new products. The industry's competitive position, and in particular the development of new products, depend importantly on the regulatory framework. Hence the regulators themselves have tended to be active in development work alongside the exercise of prudential supervision.

9.7.3 In my opinion, this feature of the insurance scene is acceptable and indeed, in some degree, inevitable. I do not see any problem in principle in having an objective to support the development of successful insurance industries bringing economic benefit to the Islands. For the most part, the objectives of supervising to the highest international standards and supporting the development of a successful industry will be entirely consistent and mutually reinforcing.

9.7.4 There may, however, be occasions when the two objectives either are or appear to be in conflict. If the regulators feel under pressure to facilitate commercial success in the short term, they may be tempted to compromise on regulatory standards. If, again, they are too zealous in the promotion of new products, there may again be temptations to compromise. Their impartiality as regulators may be, or appear to be, compromised. Appearances are important as well as the reality.

9.7.5 In my opinion the solution lies in the observance of two key principles, both accepted by the regulators in all the Islands:

- First, they have an absolute duty not to sacrifice regulatory standards to commercial advantage. Their first responsibility must be to protect the interests of customers and the Islands' wider reputations.

- Second, they need to be, and be seen to be, impartial. This is entirely consistent with supporting the industry's progress, facilitating the development of new products and effectively publicising the regulatory regime. It is not consistent with "hard selling" or aggressive marketing.

*(b) Flexibility and differentiation*

9.7.6 The regulatory regimes need explicitly to recognise the diversity of insurance products and the differing requirements for regulation. The regulatory requirements for life assurance products, sold to the general public, are markedly greater than those for the captive insurance vehicles of large companies.

9.7.7 The Island authorities have been fairly successful in tailoring regimes to legitimate customer requirements. As discussed below, however, the legislation could arguably differentiate more clearly between retail and wholesale business.

*(c) Division of responsibilities between supervisors*

9.7.8 The division of duties between insurance supervisors in the Islands and those in parent company jurisdictions is different, and less fully specified, than in the banking sector.

9.7.9 The Island supervisors rightly take responsibility for supervision of all Island-based insurance companies operating on the Islands. They apply similar supervision, moreover, to any companies from outside the Islands who operate there, though solvency aspects remain the responsibility of the home supervisors.

9.7.10 As already discussed, many of the insurance companies operating in the Islands have parent companies which are subject to regulation in other, mostly onshore, jurisdictions. This is indeed a source of strength for the Islands' industries. The Island authorities sometimes insist on consolidated supervision by the parent company's supervisors as a condition for granting a licence. The International Association of Insurance Supervisors brought out in September 1997 a statement of principles for supervision of international groups. In my opinion there is a strong case for having explicit agreements with the supervisors of parent companies.

*(d) Conduct of business*

9.7.11 As in the banking sector, insurance supervision has traditionally been concerned with prudential and solvency issues. Conduct of business supervision in the widest sense, including not just marketing of insurance products but also business conduct generally, is only now beginning to be developed in the main onshore centres. The Guernsey authorities have recently made a beginning on this and all the Island authorities keep in close touch with debates elsewhere on these matters. I hope that they will set a firm objective to follow best international practice in the development of such supervision.

## 9.8 Legislation

9.8.1 All the Islands have legislation in place to govern their insurance sectors: the Insurance Business (Guernsey) Law, 1986, as amended, the Isle of Man Insurance Act 1986, as amended, and the Insurance Business (Jersey) Law, 1996.

9.8.2 The legislation provides, as one would expect, for the licensing of insurance providers, minimum solvency margins, reporting requirements and powers of investigation and intervention.

9.8.3 In all cases, the legislation covers both domestic insurance, for Island residents, and offshore insurance for non-residents. As discussed above, however, the requirements of the domestic and offshore sectors are very different, as are the requirements within the offshore sector itself.

9.8.4 In preparing their legislation, the Island authorities responded to these differing requirements in somewhat different ways:

- The Guernsey legislation provides limited discretion for the FSC regulators, including restricted powers of "waiver" in relation to approved assets and paid-up capital. The solvency margin requirements, however, reflect UK and EU standards although calculated on a different basis.

- The Jersey legislation provides considerable discretion for the FSC regulators.

- The Isle of Man legislation couples a similarly discretionary approach with setting of certain key requirements at the lowest level of need for any category within the regulated population.

9.8.5 The discretionary nature of the legislation has not prevented the authorities in the two Islands from implementing effective regulatory systems over the past ten years. It is not clear from the legislation, however, what the precise regulatory regimes for individual sectors, in particular the life insurance sector, are in practice. The authorities have dealt with the problem by producing explanatory guides.

9.8.6 The authorities in all the Islands are reviewing their insurance legislation. In my opinion, consideration should be given to a new structure comprising:

- separate laws for the domestic and offshore business, and

- within the offshore business law, separate provisions for captive and commercial business on the one hand and life insurance business on the other.

9.8.7 Especially important in this connection, as all the Island FSCs recognise, is a well-defined regulatory regime for the life insurance sector, where members of the public are directly at risk.

9.8.8 The Island authorities will also do well, in my opinion, to deal at the same time with a number of other issues for consideration on the legislation.

9.8.9 In the Isle of Man, the main such issues appear to be solvency margin requirements, which are being reviewed against the latest UK and EU standards; prescribed valuation criteria for appointed and consulting actuaries, so as to ensure consistent reporting standards; and strengthened forms of actuarial certificate. The Island authorities are looking at all these areas.

9.8.10 In Jersey, the issues for consideration identified by the insurance consultant include the extent of the authorities' discretion to grant licences, the obligations of appointed actuaries, specific enforcement and wind-up powers, powers to co-operate with overseas regulators, and waiver and exemption powers. The authorities propose to correct an error in the legislation concerning some retention of powers by the Island's Finance and Economics Committee.

9.8.11 I hope that the Jersey authorities will give serious consideration to these points and make all necessary changes. In the meantime they are co-operating closely with the UK authorities over supervision of the principal life insurance fund established on the Island.

# 10 COMPANIES

## 10.1 Introduction

10.1.1 The Crown Dependencies, like other offshore centres, have developed substantial businesses as international company registration and administration centres.

10.1.2 As set out in the table at Box 10.1, about 90,000 companies are incorporated in the Islands. The Isle of Man has about 42,000 locally incorporated companies; Jersey, about 32,000; Guernsey, about 16,000. In all cases, the vast majority are private companies.

10.1.3 In comparison with other offshore centres, these figures are not especially large. As set out in Box 2.1, Hong Kong has 477,000 companies; the British Virgin Islands, 302,000; Cayman, 41,000; and Gibraltar, 25,000.

10.1.4 These figure compare with about 1.1 million companies on the UK's registers.

10.1.5 As the Box 10.1 table indicates, there are many further companies that operate in or are administered from the Islands but are incorporated elsewhere. The precise numbers are not known. But in Guernsey it is believed that the numbers could be of a similar magnitude to the numbers of incorporated companies. In the Isle of Man, there are believed to be many fewer non-locally- incorporated companies, possibly less than 3,000 (including 1,870 on the Island's "F" Register).

10.1.6 The company registrations business brings substantial fee earnings to the Islands. The company business as a whole brings significant amounts of local employment.

10.1.7 The Islands' company sectors have also been a source of concern to the Island authorities because of the potential they offer for concealment of disreputable purposes and bad publicity. The concern extends to companies administered on the Islands but incorporated elsewhere as well as to companies incorporated in the Islands. In this respect, too, the Islands are not unique. Other company registration centres, onshore as well as offshore, have encountered similar problems.

## 10.2 Nature of the Islands' company sectors

10.2.1 The Islands' company sectors differ markedly from those of the onshore jurisdictions. Most companies registered or operating there are owned by non-resident individuals, Trusts or companies conducting business or holding assets outside the Islands. The Islands' service providers offer clients company vehicles in much the same way that they might offer them life assurance products, mutual fund holdings or banking facilities. Conventional trading companies are a minority.

10.2.2 The companies owned by individuals overseas or by Trusts are mainly convenient vehicles for holding wealth of various kinds, such as real estate, works of art, yachts, share portfolios, business interests or other investments.

10.2.3 Such companies often form part of a pyramid structure, with a Trust at the top owning a variety of separate companies which in turn may own trading companies. These structures may enable individuals to enjoy simultaneously the benefits of Trust and company vehicles. The benefits are likely to include confidentiality and tax advantages, depending on the beneficiaries' residence, domicile and local tax regimes, as well as limited liability. The company format also enables individuals or Trusts to segregate assets into separate, self-contained parcels and thus to give separate legal identity to individual parcels of wealth or business interests. Company vehicles also make Trust facilities more accessible to overseas residents not familiar with Trusts.

10.2.4 For multinational or overseas companies, the Islands' company vehicles may offer substantial advantages in tax

savings and convenience. Such companies may find these vehicles advantageous for headquarters and treasury functions, international trading functions, collective investment funds, captive and life insurance business, pensions and share options business, and leasing business as well as asset holding.

10.2.5 Another important difference in the Islands compared with the large countries is that corporate service providers (CSPs), also known as company formation agents or company managers, play a much more important part in the company sector, as also in the Trust sector. CSPs are responsible for most company formations. They also provide Director, management, administration and company secretary services for many companies serviced from the Islands. Providers of such services include banks, lawyers and accountants as well as dedicated service providers. Some are branches of multi-national CSPs. A similar pattern is found in most other offshore centres.

10.2.6 In the larger countries, such as the UK, there are many organisations providing similar services, including facilities for incorporating companies in any international centre of the client's choice. But they are less prominent than in the Islands.

### 10.3 Policy objectives

10.3.1 The Islands have all set out to build up businesses as international company registration and administration centres. The Isle of Man has the largest business. Jersey and Guernsey have adopted a more selective approach.

10.3.2 As discussed above, the presence of these businesses brings substantial benefits to the Islands in fee income and local employment, on which taxes are levied. The legal, registration, regulatory and tax systems have all been designed to promote such business.

10.3.3 The Islands face strong competition for this business from other offshore centres.

### 10.4 Company law

10.4.1 Each of the Islands has its own company and tax legislation to support its company registration and administration businesses. The principal company legislation is listed at the end of the Island sections. Much of it is similar to UK Company legislation. But there are important differences, especially with regard to registration requirements and regulation. The tax legislation is quite different.

### 10.5 Registration and regulation: UK model

10.5.1 In the UK, there are no restrictions on who may form or register a company. Neither is there any requirement to declare beneficial ownership where this differs from nominal ownership. Company registration and regulation systems are designed with the following objectives (among others) in mind:

- to give companies a legal identity and, if they so choose, limited liability;
- to make publicly available, for the benefit of potential customers and suppliers as well as shareholders, information about the company's Directors and ownership, areas of activity and financial performance;
- to ensure that Directors fulfil their duties to shareholders and that shareholders are properly informed and consulted about what their company is doing and achieving;
- to ensure that accounts are prepared in prescribed formats conforming to EU Directives, audited by approved auditors, made available to shareholders, and (in the case of limited companies) publicly filed; and
- to enable the authorities to investigate and pursue trails in case of need.

10.5.2 In the UK, the public disclosure requirements associated with these objectives follow and in certain respects go beyond the relevant EU Company Directives of 1978, 1983 and 1984. All the information disclosed is made public at Companies House and has to be kept up to date in annual returns (more frequently in some areas).

10.5.3 The UK and EU disclosure regimes go much further than those of the US and Canada, where only companies listed in the Stock Exchanges have to file accounts.

10.5.4 For companies *incorporated in the UK*, the main elements that have to be disclosed (and updated) are:

(a) the Company's name, the address of its registered office and the nature of its business;

(b) the Company's Memorandum and Articles of Association, including particulars of share capital and any subsequent changes;

(c) the names and addresses of the Directors and Secretary of the company, including "Shadow" Directors (if any) who give instructions or directions to the Directors;

(d) the place where the register of the Company's members and debenture holders may be inspected;

(e) in the case of limited companies, annual filing of audited accounts in a prescribed format (abbreviated for small companies);

(f) an annual report by the Directors reviewing the development of the company's business and its principal activities.

10.5.5 For companies *not incorporated in the UK* but doing business there, the requirements are similar. These "oversea" companies too appear on the public register of companies. The disclosure format requirements are, however, less prescriptive and there is no audit requirement (though companies incorporated in the Crown Dependencies but carrying on business in the UK are subject to an audit requirement).

10.5.6 The UK's disclosure regimes are rigorously enforced, with fines for non-compliance. The Department of Trade and Industry is able, moreover, to appoint inspectors to investigate and report on a company's membership.

### 10.6 Registration and regulation: Island models

10.6.1 In the Islands as in the UK, the registration and regulation regimes are designed to give companies a legal identity and, if they so choose, limited liability, in return for providing certain information. But there are important differences, both between the Islands and between the Islands and the UK.

10.6.2 The main differences are:

- First, the authorities in Jersey and Guernsey *vet* applications for new company registrations. They do this through Control of Borrowing legislation which provides relevant statutory powers. In Jersey, all applications for company formations requiring consents under this legislation have to be made by advocates or solicitors of the Royal Court or by accountants practising in Jersey. In Guernsey, similarly, all applications for company formations have to be made to the Royal Court through Advocates, who are responsible for due diligence investigations of the applicants. In the Isle of Man, on the other hand, as in the UK, registration is automatic provided that the necessary documentation and fees are provided. There is no longer a requirement to detail permitted activities in Memorandums of Association.

- Second, the Jersey and Guernsey authorities require some *confidential disclosures* to the authorities at the time of incorporation as well as public disclosures. In particular, they require companies to identify who the *beneficial owners* are in cases where these differ from the nominal owners. Only exempt companies, however, (and international companies in Guernsey) are required to notify any subsequent changes. The Isle of Man authorities do not require disclosure of beneficial ownership or other confidential disclosures, though the "Know your customer" principle in the anti-money-laundering Code will require those involved in forming companies to know for whom they are working.

- Third, there are no *minimum capital requirements* in Jersey or Guernsey for unregulated companies, either public or private. The Isle of Man does make such requirements.

- Fourth, the Jersey and Guernsey authorities have not in the past required *companies administered or operating in*

*the Islands but incorporated elsewhere* to register or to file any details. The Isle of Man authorities do require such companies to be registered on a separate register known as the F Register. They are required to lodge basic details of Memorandum and Articles, the Directors and Company Secretary, and the Company's authorised local agent. The coverage of the F-Register is believed, however, not to be comprehensive.

- Fifth, the Islands do not require private companies (which form the vast majority) to publish annual accounts or Annual Reports by the Directors. Jersey requires all companies to *produce* accounts. Public companies are required to have them audited and to file them publicly. Private companies need only have their accounts audited if the Articles so require or a majority of members so resolve. The Isle of Man requires public companies to *produce and publish* such accounts. Private companies must produce accounts if members so require but this requirement is not enforced. Guernsey law requires all companies to *maintain* accounts but here too there is no requirement to publish audited accounts or annual reports.

- Sixth, the authorities in Jersey and the Isle of Man have powers to appoint *inspectors* to investigate companies but the Guernsey authorities do not.

### 10.7 Vetting of registrations

10.7.1 In my opinion, there is no absolute need to vet company registrations. The vetting process is bound to take some time. It reduces business for centres that practise it. Provided that the authorities are able subsequently to identify and de-register companies whose businesses are unacceptable and risk bringing the centre into disrepute, initial vetting may not be strictly necessary. And regulated service providers may be able to take on some of the same functions.

10.7.2 But the case in favour of vetting seems to me very strong. It is important to know the owners, scale and purposes of companies, especially if they will not be required to file any information about their activities. In this as in other areas of regulation, there is much to be said for nipping potential problems in the bud. Stopping companies from registering in the first place seems easier and better than allowing them to register and then trying to identify and de-register them subsequently.

10.7.3 The case for vetting is especially compelling, perhaps, in centres which are vulnerable to abuse by clients and to bad publicity. It has a further role to play in centres where the pressures on resources limit the amount of new business that can be taken on. I would therefore support the approach that Jersey and Guernsey have adopted. I hope that the Isle of Man will consider it too.

### 10.8 Beneficial ownership

10.8.1 The requirement to disclose beneficial ownership at registration, and changes in beneficial ownership subsequently, where the beneficial ownership is different from the registered ownership, raises some analogous issues.

10.8.2 In the larger countries, practices vary. The French and German authorities reckon to collect and hold information about beneficial ownership of companies incorporated within their jurisdictions. The UK authorities, as discussed above, do not require such disclosure but do make a requirement (which may in many cases amount to the same thing) that "shadow" Directors be included on the register alongside the actual Directors. The Isle of Man makes a similar requirement.

10.8.3 So far as I am aware, disclosures of beneficial ownership are made in confidence to the authorities, and not published, in all the centres where they are a requirement. In general, this seems to me reasonable. There may be valid commercial reasons why companies should not be obliged to disclose their beneficial ownership publicly.

10.8.4 The main reason for requiring confidential disclosure of beneficial ownership is that companies, in particular private companies, have come to be favourite vehicles for criminals and money launderers. Especially in the absence of regulation, company structures can be abused to conceal and disguise disreputable purposes as well as providing limited liability. More than ever before, therefore, the authorities need to know who really owns companies and directs them.

10.8.5 Some additional considerations are:

- First, the point of requiring companies to disclose shareholders and Directors is so that people who need to know

may know who the person is (or people are) who own and run the company. If the shareholders and Directors are not the real principals, the real principals should be disclosed as well.

- Second, the disclosure requirement may deter the disreputable from applying for registration or incorporation in the first place.

- Third, information about beneficial ownership is likely to be valuable in constructing databases of Island enterprises and the connections between them and as a cross-check on the diligence of service providers.

- Fourth, this information will be especially relevant should there ever be criminal or money laundering trails to investigate.

- Finally, although the unscrupulous may of course misrepresent or fail to declare the beneficial ownership, the offence of a false declaration may be helpful in enabling the authorities effectively to enforce the regulation and strike off the offending companies.

10.8.6 The case against requiring disclosure of beneficial ownership is:

- First, the requirement may reduce business, including reputable as well as disreputable business. But companies continue to be incorporated in Jersey and Guernsey in spite of the requirement for confidential declaration of beneficial ownership.

- Second, the business lost may go to other centres where standards are lower and the pursuit of crime less effective. There may be some truth in this. But a key objective for world-class financial centres should be to deter disreputable business. Even if other business is lost in the process, the increase in good business is likely in due time to offset such losses of business in the short term.

- Third, as the Isle of Man authorities have represented to me, unscrupulous people are likely to misrepresent or (more likely) fail to declare the beneficial ownership even if there is a disclosure requirement. Asking them to declare it may only encourage them to multiply the layers of concealment. There may be some truth in this, too. As discussed in the preceding paragraph, however, the offence of a false declaration may be an invaluable element in the prosecution of disreputable activity.

10.8.7 The arguments in favour of requiring confidential disclosure of beneficial ownership, as in Jersey and Guernsey, and also shadow directors, seem to me clearly to outweigh the arguments against. With the burgeoning of financial crime and money laundering through company vehicles, the combating of crime needs to be a principal concern in company regulation. Company regulation and law enforcement need to work together to combat crime.

10.8.8 In my opinion, therefore, Jersey and Guernsey are right to require confidential disclosure of beneficial ownership when companies are formed. It is no less important that companies or their agents be obliged to report subsequent changes in beneficial ownership. Without this, the unscrupulous can easily avoid the disclosure requirement without any breach of regulation.

10.8.9 I hope that the Isle of Man authorities, too, will be willing to require such disclosure. They have proposed, rightly in my view, that corporate services providers should be required to obtain and keep information on beneficial ownership. In my opinion, this is much better than nothing but should preferably be supplemented, and enforced, by an obligation to disclose the information in confidence to the authorities.

10.8.10 In this as in other areas, it would be far better if all offshore centres pursued the same good practices. Chapter 17 discusses the prospects for developing such co-operation. But there are some areas, including regulation of companies, where the case for setting high standards stands in its own right and such standards are in the Islands' own best interests.

10.8.11 The larger British Caribbean Territories mostly now require company managers or agents to ensure that those who asked them to establish the company are reputable and that either they or those by whom they were instructed know the identity of the beneficial owner. In my opinion, this requirement, too, is better than nothing. But there must be concerns about delegating due diligence responsibilities in this way.

10.8.12 In the UK, the requirement to disclose shadow Directors may achieve some of the same effect as disclosure of

beneficial ownership. I hope, however, that the UK authorities too, in their company law review, will be considering the case for adding a requirement for confidential disclosure of beneficial ownership.

### 10.9 Companies operating on the Islands but incorporated elsewhere

10.9.1 Neither the Jersey nor the Guernsey authorities have in the past required companies administered or otherwise operating in the Islands, but incorporated elsewhere, to register with the authorities at all unless the companies apply for tax-exempt status (in which case disclosure of beneficial ownership is required as well). As discussed earlier, there appear to be many such companies.

10.9.2 Although the Islands' tax authorities may have some details of these companies, the company registration authorities have none and are generally unable, therefore, to assist the authorities in other countries who make enquiries about them.

10.9.3 In the Isle of Man, such companies are required to file basic information on a separate "F" register. There is some chance, therefore, of pursuing trails through these companies in case of need. But the coverage is not comprehensive and the information required is very limited. It does not include beneficial ownership, nature of the business or country of incorporation (though the last of these will be apparent from other filed documents). There is, however, a requirement to register shadow directors and to file certain charges.

10.9.4 The Island authorities now feel that they cannot afford to know nothing about companies in this category. In my opinion, they are right. In Jersey and Guernsey, companies administered from the Islands can readily avoid the vetting and registration processes by incorporating elsewhere. In the Isle of Man, too, the far from comprehensive coverage of the "F" Register means that some companies administered from the Islands may be able to preserve total anonymity.

10.9.5 The Jersey authorities did not feel able to estimate how many such companies operate on the Island. The Guernsey authorities, on the other hand, believe that there are probably more such companies than locally incorporated companies. This helpfully indicates the likely scale of the problem. In the Isle of Man, where incorporation is largely automatic and less disclosure is required, there are believed to be many fewer non-locally -incorporated companies (see Box 10.1).

10.9.6 Solutions are still being considered. In my opinion, such companies should preferably be subject in all the Islands to registration and disclosure regimes similar to those for locally incorporated companies. The Alderney authorities have, I believe, already decided on this course.

### 10.10 Disclosure of accounts and requirements for audit

10.10.1 There has long been a perception in the larger economies, especially in Europe, that companies which receive the benefits of a separate legal personality and limited liability should be expected, as a quid pro quo, to disclose financial information. Customers, suppliers, staff, shareholders, investors, lenders and public authorities doing (or planning to do) business with the company have been seen as having a legitimate interest in knowing what the nature, scale, assets base, earnings and financial circumstances of the company are. Publication has been seen as the best means of meeting such needs.

10.10.2 The EU decided in its Company Law Directives of 1979, 1983 and 1984 to set common requirements throughout the EU countries for the public filing of audited accounts in a prescribed form and for the use of suitably qualified auditors. The idea was that company accounts should mean the same, and be professionally audited, regardless of where in the EU they are produced.

10.10.3 The UK's 1985 and 1989 Companies Acts gave effect to these Directives in the UK. The Acts apply to all audited companies. Small companies, with a turnover of less than 2.8 million, gross assets of less than 1.4 million and less than 50 employees, or any two of these, are allowed to file accounts in an abbreviated form. Companies with annual turnover of less than 350,000 are exempted from the audit requirement.

10.10.4 In the Crown Dependencies, as in other offshore centres, the requirements to *disclose* financial information are very limited. In Jersey and the Isle of Man, as explained above, only public companies (a small minority) and other regulated institutions are required to file accounts. In Guernsey, no companies other than regulated institutions are required to do so. Many people wishing to set up private company vehicles are attracted by the lighter disclosure requirements, which enable

them to keep their affairs more confidential as well as reducing workload. Offshore centres are generally reluctant to impose such requirements for fear of losing business.

10.10.5 The requirements on keeping audited accounts (as against filing them) vary between the Islands:

- In Jersey, all companies are required to produce accounts and public companies are required to have them audited (as are bankrupt persons and companies). For private companies, an audit is required unless a majority of members of the company decide against it.

- In Guernsey, companies are obliged to keep audited accounts unless they are dormant or asset holding companies whose shareholders have unanimously elected for unaudited status.

- In Alderney, a company can be unaudited if the articles do not require audit and all the members agree in writing that audit is not required.

- In the Isle of Man, all companies are required to keep audited accounts unless they have a very low turnover.

10.10.6 For the most part, requirements to keep accounts are not enforced.

10.10.7 In my opinion there is a presumption, in this as in other areas, in favour of conforming to EU standards in the Islands. On this basis, all limited companies would be required both to keep audited accounts and to file them publicly, with much abbreviated requirements for small companies. From a regulatory standpoint, that seems to me the best solution.

10.10.8 It is arguable, however, that the EU countries and now the EU itself have devised these requirements with trading companies rather than private asset holding companies principally in mind. As discussed above, the vast majority of companies in the Islands are private asset-holding companies. There may therefore be a case for a somewhat different regime for such companies.

10.10.9 In my opinion, the same *quid pro quo* considerations which point to disclosure requirements for trading companies do also apply in some degree to asset holding companies as well.

10.10.10 If society permits persons involved in an activity, including holding and use of assets, to protect the activity (or the assets) by means of a separate legal personality with limited liability, so that the rest of their assets would not be available to creditors or suitors in the event of insolvency or other forms of liability, it is arguable at least that society should have access to basic information about who the persons are, what the assets are and what the associated liabilities might be. Without a modicum of financial information, in particular, the nature, scale and significance of the company will remain opaque.

10.10.11 A further consideration is that asset-holding company vehicles are as open to *abuse* as other company vehicles. The less information is available about them, the greater the risks of abuse must be. The authorities in an international finance centre should not lightly, therefore, in my opinion, offer legal personas and limited liability facilities for the convenience of non-residents wishing to hold and protect assets in this way without requiring access in return to some basic information about the nature and scale of the activity. Without such information, there is a risk that disreputable activity will remain concealed. It will likewise be difficult to pursue money-laundering trails.

10.10.12 If the authorities feel that regimes of full and public financial disclosure on EU lines would be too great a step to take at this stage, without similar action by other centres, offshore and onshore, there are intermediate options that could be considered:

- First, private, non-trading, asset-holding companies could be required to submit information to the authorities in confidence, either automatically or on request, rather than make public disclosures.

- Second, small companies generally, including all non-trading asset-holding private companies, might be permitted to file much abbreviated accounts, perhaps limited to a single page, when they are subject to a filing requirement.

10.10.13 It may be argued that the requirement to *keep* audited accounts is at least as important as the requirement to file them publicly. I have some sympathy with this. However, a requirement to *submit* accounts, even a single-page summary, is much the best way to enforce the requirement to *keep* audited accounts.

# 11 DIRECTORS AND PARTNERSHIPS

### 11.1 Directors and disqualification

11.1.1 As in the UK, the Company legislation in all the Islands (including Alderney as well as Guernsey, Jersey and the Isle of Man) lays certain duties and obligations on Directors of companies incorporated in the Islands. In some cases it applies also to Directors of companies operating in the Islands but incorporated elsewhere.

11.1.2 In all four Islands, as in the UK, the Directors of a company remain personally responsible and liable even though the company delegates to other persons the power to contract.

11.1.3 Corporate Directors are permitted in Guernsey but not in Jersey. The Isle of Man requires that all companies incorporated in the Island must have at least two Directors who are individual persons.

11.1.4 The Courts have powers to disqualify people from acting as Directors for significant periods of years. The grounds for disqualification and the penalties vary somewhat from Island to Island:

- In *Jersey*, the Royal Court can disqualify the Directors of any company, wherever incorporated, for up to 15 years in insolvency cases. In other public interest cases, the Court can disqualify persons from acting as Directors of Jersey companies for up to 5 years. There are proposals to extend the latter powers to include companies administered or carrying on business in Jersey but incorporated elsewhere and to raise the maximum disqualification period to 15 years.

- In *Guernsey* and *Alderney*, the Courts may disqualify a person for up to 5 years on public interest grounds from acting as a Director or officer of locally incorporated companies. The powers are not limited to cases of insolvency. The period of disqualification may be extended for a further 5 years. Neither Court, however, has power at present to disqualify persons from acting as Directors of companies incorporated outside the Islands.

- In the *Isle of Man*, the Court may disqualify persons from acting as Directors of any company, wherever incorporated, for between 3 and 15 years if they are considered unfit (for example, if they have committed offences under the Companies Acts). In liquidation cases, the maximum disqualification period for a person found guilty of fraud is 5 years. It is proposed that the new Insolvency legislation should raise this limit, too, to 15 years.

11.1.5 In practice, no Directors have so far been disqualified in either Guernsey or the Isle of Man, though three licenceholders in the Isle of Man have been disqualified following actions by the FSC there. The Royal Court in Jersey has disqualified three persons under the bankruptcy law.

11.1.6 It is clearly in the best interests of any international finance centre to promote high standards in the Directors of the companies associated with the centre. This requires suitable legislation and effective enforcement.

11.1.7 The *legislation* needs to:

- lay on Directors individually appropriate duties and responsibilities which cannot be ducked through general powers of attorney;

- make provision for a Code of Conduct for Directors;

- give the authorities wide powers, not confined to insolvency or bankruptcy cases, to disqualify Directors for a significant period of years;

- extend to Directors of companies administered or otherwise operating on the Islands but not incorporated there.

11.1.8 As discussed above, the Islands have much of this in place already.

11.1.9 The Island authorities have recognised, however, that disqualification powers should be extended in all cases to Directors of companies operating locally but not locally incorporated. Such Directors, if unfit, can do as much harm as the Directors of locally incorporated companies.

11.1.10 The maximum disqualification periods, similarly, might preferably be standardised at 15 years in all cases.

11.1.11 As discussed below, moreover, there is a case for developing Island Codes of Conduct for Directors.

11.1.12 No less important is effective *enforcement*. The authorities need not only to have the necessary powers but also to use them. They need in particular to make a practice of disqualifying Directors who are dishonest, negligent or incompetent and risk bringing the centres into disrepute.

11.1.13 The limited number of disqualifications made so far doubtless reflects in part the recent introduction of the legislation. It will also, however, be important to ensure, where this does not already happen, that some official person or body such as the FSC has an explicit responsibility for launching disqualification procedures in public interest as well as insolvency cases.

11.1.14 In all the Islands, corporate service providers supply Directors and other company officers for the many companies owned by non-residents. There are plans in each Island to regulate the activities of these providers, including their provision of Director services. It should be possible to use this opportunity to provide for promoting high standards among Directors generally.

### 11.2 "Nominee Directors"

11.2.1 The reputation of all the Islands has suffered in recent years from the presence on the Islands, especially Sark, of so-called "nominee" Directors. The problem has come to be associated with Sark. But "nominee" Directors appear to be present, in smaller concentrations, in other centres as well. I was told that in at least one onshore jurisdiction the banks provide many such Directors.

11.2.2 Although formally Directors, some of these "nominee" Directors are Directors of so many companies that they could not credibly discharge the proper duties of a Director with respect to all of them, especially in cases where they have no professional or technical support.

11.2.3 In Sark itself, where the total population is 575, information fairly readily publicly available in the autumn of last year indicated that:

- total Directorships held by Sark residents may have been around 15,000 or more;
- 3 residents appeared to hold between 1600 and 3000 Directorships each;
- a further 16 residents appeared each to hold more than 135 Directorships each; and
- a further 30 residents appeared each to hold between 15 and 100 Directorships.

11.2.4 These figures are no more than broad orders of magnitude. On the one hand, they do not include any Directorships of companies incorporated in the Caribbean centres (where information was not readily available). On the other hand, they may include some Directorships, at least, in companies that had been wound up. There appears to be a high rate of turnover in the companies concerned.

11.2.5 Whatever the precise figures may be, the perception has arisen that many of the Directors on Sark are Directors in name only, not in substance, and that the real Directors (that is, the "shadow" Directors in terms of UK legislation, or the beneficial owners) are other people altogether.

11.2.6 This perception has gained force from reports that the Directors concerned sometimes assign their powers as Directors by general power of attorney to others (the "shadow" Directors or beneficial owners) and provide undated letters of resignation.

11.2.7 The people or companies who employ "nominee" Directors must clearly have reasons for doing so. To understand what these may be, it is necessary to look at the nature of the companies concerned.

11.2.8 In the case of Sark, a high proportion of the 15,000 total Directorships identified as being held by Sark residents last autumn were with non-resident companies registered in the Isle of Man (often with well-known onshore accountancy firms acting as registration agents). The rest were mostly with companies registered in the UK, Ireland and Panama.

11.2.9 As discussed in section 10.10, owners of assets or business interests in other jurisdictions, or professional advisers on their behalf, have found that they can obtain the twin benefits of secrecy and tax-free status by forming non-resident companies in (say) the Isle of Man, with "Directors" in (say) Sark. The price of these benefits is a non-resident company fee of 750 a year and fees of around 100 a year for a couple of "nominee" Directors.

11.2.10 The secrecy results from the limited disclosure requirements for non-resident companies in the Isle of Man (where there is no requirement to declare beneficial ownership to the regulatory authorities or to make substantive reports to the Tax authorities unless challenged) and the absence of any disclosure requirements in Sark (where there is no company legislation and no regulation of companies or Directors).

11.2.11 The avoidance of tax is achieved (or maintained) through the use of Sark Directors to establish that the companies are resident for tax purposes in Sark, where there is no tax.

11.2.12 The owners may still be liable for tax in their own home jurisdictions. But there may be possibilities to evade or avoid that as well and to mask other disreputable activities.

11.2.13 When the activities in Sark first came to prominence in the 1980s, the nature of the problem was different. It was common practice at that time for the Directors of Guernsey and Jersey companies beneficially owned overseas to have two Sark residents as Directors and to hold Board meetings in Sark so as to create the fiction that that they were managed and controlled outside Guernsey and Jersey. That enabled the companies to claim tax exempt status under the Guernsey and Jersey tax rules of the time without incurring any tax liabilities elsewhere (since there is no company tax on Sark).

11.2.14 The Guernsey and Jersey authorities stopped this practice, however, by establishing new rules for tax exempt companies which allowed them to hold Board meetings in Guernsey or Jersey.

11.2.15 Another facet of the problem has been that some companies and individuals have sought to establish by means of false addresses that they are resident in Sark when they are not. At the suggestion of the Sark authorities, the Guernsey authorities recently brought in a False Domicile etc (Bailiwick of Guernsey) Law 1998 to deal with this. The new legislation makes it an offence to misrepresent where a person is resident. It would now be an offence, therefore, to pretend that a company's Directors are resident in Sark when they are not.

11.2.16 As the Guernsey and Sark authorities recognise, however, the main problem has still to be solved. People on Sark and the other Islands, as indeed in other centres, are still able to act as "nominee" Directors of companies about which they know little or nothing. They can do this, moreover, without any misrepresentation of domicile. A case now before the Courts in England indicates that acceptance of such Directorships may expose those concerned to greater risks of litigation than previously foreseen. But a full solution will require further legislation and a measure of regulation.

11.2.17 In theory the problem could be solved by means of action in other jurisdictions, across the world, to remove the *demand* for "nominee" Directors in Sark and other low-tax jurisdictions. Changes in the Isle of Man's rules for the regulation and taxation of companies registered there, for example, could choke off the business associated with Isle of Man companies. Even if the Isle of Man authorities take such action, however, as discussed in section 10.12, the demand for "nominee" Directors will probably not disappear. Other finance centres willing to host such schemes will probably be found.

11.2.18 The authorities in Guernsey, Alderney and Sark have agreed, therefore, that the problem of "nominee" Directors must be solved by means of new legislation with application throughout the Islands of the Bailiwick. The legislation would not prohibit Sark residents from acting as Directors but would enable and oblige the Guernsey FSC (as being the only central body in a position to do so) to regulate those who provide Director services anywhere in the three Islands.

11.2.19 In my assessment, the main elements in such legislation would preferably be as follows:

- *Licensing or registration of Directors*. All those, throughout the three Islands of the Bailiwick, who serve as Directors or Trustees by way of a business would need to be licensed or registered by the Guernsey FSC as being fit and proper persons to provide such services, in terms of integrity, solvency, competence, track record and technical support. A licence fee would be needed to cover the FSC's costs.

- *Codes of Conduct*. Provision would be made for Codes of Conduct governing the standards of conduct and diligence expected from Directors and Trustees. Directors would be required above all:

  (a) to be aware of their legal responsibilities and liabilities as Directors;

  (b) to ensure that they have effective control of the company they direct;

  (c) to avoid conflicts of interest;

  (d) to know who owns the company;

  (e) to know what the company's business is;

  (f) to know what its finances are;

  (g) to have full and up to date information;

  (h) to ensure that proper accounts and records are kept;

  (i) to ensure that the company is not being used for illegal purposes, trading wrongfully or breaking the law in other ways;

  (j) to ensure that the company's tax arrangements would remain sustainable if publicly known and that tax returns are promptly and correctly made;

  (k) to ensure that they have adequate support to enable them to discharge their responsibilities as Directors; and

  (l) not to duck these responsibilities by assigning them to others.

- *Number of Directorships*. Directors would be obliged not to hold an unreasonable number of Directorships. No specific ceiling number would be set, since the manageable number would depend critically on the nature of the companies and the amount of professional and technical support available to the Director. Beyond a certain level, however, perhaps 5 trading companies from different groups or 30 asset holding companies, consultation with the FSC might be required.

- *Enforcement*. It would be an offence to serve as a Director or a Trustee by way of business without being properly licensed or registered. The FSC would have the power and the duty to enforce this.

- *Disqualification*. The FSC would also have the power and the duty to disqualify persons failing to discharge their duties adequately, in terms of the Code of Conduct.

- *Annual returns*. All those providing Director services on the Islands would be obliged to file an annual return to the authorities stating the ownership, place of incorporation and main activities of the companies they serve as Directors (except quoted companies or companies authorised by the FSC).

11.2.20 A regime on these lines should dispose of the problem once and for all. It would enable suitably qualified residents of Sark and the other islands to continue serving as Directors while removing the scope for the abuses which have detracted from the Islands' reputation.

11.2.21 The representatives of Guernsey, Alderney and Sark whom I met all seemed fully committed to finding an early

solution along these lines. I am sure they will be right to do so. The details will naturally require careful consideration.

11.2.22 The Guernsey authorities, who alone are in a position to take the lead in such matters, hope to bring forward new legislation for this purpose ahead of the other legislation they are planning for the regulation of fiduciaries. A Director of Fiduciary Business has been appointed. Their aim is to have the new law and regulation in place by September 1999.

### 11.3 Partnerships and Limited Partnerships

11.3.1 The Islands all have legal frameworks similar to that in the UK for Limited Partnerships as well as the traditional unlimited partnerships. Jersey has also introduced a framework for Limited Liability Partnerships, with effect from 9 September 1998.

11.3.2 Most professional practices in law and finance take the form of *unlimited partnerships* with professional indemnity insurance. Partnerships conducting forms of business subject to regulation, such as investment business, are supervised like other providers of such services.

11.3.3 Jersey and Guernsey created legal frameworks for local registration of *Limited Partnerships* in 1995. Before that such partnerships were registered abroad, mostly in Delaware. The Isle of Man has had Limited Partnership legislation since 1909. The legislation was updated in 1994. Jersey now has 107 Limited Partnerships, Guernsey 53 and the Isle of Man 51.

11.3.4 These limited partnerships are mainly used as vehicles for pooled or collective investments with a small number of investors, especially in the areas of private equity and venture capital. In most cases, the beneficial owners are non-residents. One or more "general" or managing partners are jointly and severally liable for the debts and liabilities of the partnership. The other partners are liable only up to the limits of their contributions to the partnership's capital. The general partner is usually the fund manager or investment firm. The other partners are the investors.

11.3.5 Full details of the partnerships have to be registered with the authorities. In all the Islands the authorities have discretion whether or not to allow their formation. The general Partner may need to be licensed under the investment business regulatory regimes. In Jersey and Guernsey, the authorities may attach conditions to investment fund partnerships' Control of Borrowing consents. Otherwise, there is no on-going supervision.

11.3.6 In all the Islands, partnerships are not taxed as entities. The partners are taxed individually in respect of their individual shares in the partnership's profits. Resident partners are subject to tax at 20 per cent. Non-resident partners are subject to tax only on income arising in the Island (other than interest on deposits). If partners other than the general partner are non-resident, the general partner may qualify for tax exempt status.

### 11.4 Limited liability partnerships and LLCs

11.4.1 Only Jersey has so far introduced legislation for *Limited Liability Partnerships (LLPs)* on North American lines. The legislation is designed to enable the registration in Jersey of professional partnerships in areas such as accountancy, law and actuarial work.

11.4.2 As with American LLPs, the liability of the professional partners is limited in respect of their personal assets except where the partner himself (or herself) has been negligent or is otherwise made liable.

11.4.3 Limited liability partnerships, unlike Limited Partnerships, will have legal personalities of their own and be taxed on profits from trading activities, if any, in Jersey. They will be required to register and to provide a 5 million bond to be used solely for the benefit of creditors in the event of insolvency. The Jersey authorities will have discretion to accept or reject applications for registration. The bond requirement is expected to deter small partnerships from applying. The authorities have said that they are looking for partnerships of considerable size and stature and will only grant the required consents to such partnerships.

11.4.4 As with private companies in Jersey, there will be requirements for full public disclosure of partners' names and addresses and for immediate disclosure of changes. The legislation requires the maintenance of proper accounts. There is, however, no requirement for audit or publication of the accounts unless the partners themselves so decide.

11.4.5 In my opinion the Jersey authorities should consider the case for requiring audit and disclosure of accounts for trading enterprises on this scale. This would seem an appropriate *quid pro quo* for limited liability. The adequacy or otherwise of the 5 million bond will not otherwise be apparent to others wishing to do business with the partnerships. The new partnerships will not be like private, asset-holding companies.

11.4.6 The Isle of Man offers a different vehicle, somewhat confusingly called the "*Limited Liability Company*" (LLC). The legislation is modelled on a Wyoming statute of 1977. The Island had 153 LLCs at the end of June 1998.

11.4.7 Extensively used in the US, the LLC is a hybrid form of vehicle combining the tax treatment of partnerships with the limited liability of companies. It is particularly suited to joint ventures with some US involvement and as a vehicle for raising finance. Some small businesses use these vehicles as a convenient way of obtaining limited liability without double taxation complications.

11.4.8 Formally companies, with their own legal personality, limited liability and a life at present limited to 30 years, LLCs are taxed like partnerships. Profits are divided among the members and taxed accordingly. There is no requirement to disclose beneficial ownership to the authorities. Like other companies, they are obliged to keep audited accounts. But this requirement is not enforced and there is no requirement to file such accounts.

11.4.9 The issues which arise on LLCs seem similar to those discussed in the previous Chapter with regard to other companies in the Isle of Man.

# 12 TRUSTS AND TRUSTEES

### 12.1 Introduction

12.1.1 This Chapter draws heavily on a study of Trust Law and Regulation in the Islands commissioned by the Home Office at my request from Professor David Hayton. I am most grateful to Professor Hayton.

### 12.2 Trust frameworks and terminology

12.2.1 In all jurisdictions where the law makes provision for Trusts on Anglo-American lines, Trusts involve settlors, trustees and beneficiaries.

12.2.2 The *settlors* are persons or companies who transfer ownership of their assets to trustees by means of a Trust Deed. In the case of discretionary Trusts, where the trustees have some discretion as to the investment and distribution of the Trust's assets, the Deed may be accompanied by a non-legally-binding letter setting out what the settlor wishes to be done with the assets.

12.2.3 The *trustees*, who may be paid professionals or companies or unpaid persons, hold the assets in a Trust fund separate from their own assets. They invest and dispose of them in accordance with the settlor's Trust Deed, taking account of any letter of wishes. There may also be a *protector*, who may have power to veto the trustees' proposals or remove them, and/or a *custodian* trustee, who holds the assets to the order of the managing trustees.

12.2.4 All Trusts (other than Charitable or statutorily permitted non-charitable Trusts) must have *beneficiaries*, who may include the settlor, and a maximum life, known as the *perpetuity period*, of 100 years (80 years in the Isle of Man). The trustees are obliged to account to the beneficiaries for what they do with the fund. The beneficiaries are then able to enforce implementation of the Trust Deed. The settlor may be the sole beneficiary. Irrespective of whether the settlor is a beneficiary, if the settlor and the trustees agree at the outset that the trustees will always do as the settlor directs, the Courts will disregard the supposed Trust as being a sham or *resulting trust* in which the assets "result" back to the settlor so as to be available to his creditors or heirs.

12.2.5 Some Trust Deeds may, rather exceptionally, give the trustees a power to appoint income or capital of the Trust for the benefit of a wide or narrow class of persons who are different from the persons identified as beneficiaries under the Trust Deed. Such persons are known as *objects of a power of appointment* rather than beneficiaries. The Trust Deed may give the trustees power to add persons to the class of beneficiaries or to the class of objects or to delete persons from such classes. Beneficiaries cannot be excluded from the right to see the Trust accounts and make the trustees account for their management of the Trust fund but objects may be expressly excluded from such right if the settlor so wishes.

12.2.6 While Trusts must always have some ultimately ascertainable beneficiary, such Trusts may have no defined *existing beneficiaries* but only objects of a power until some person becomes entitled as beneficiary to income or capital on the expiry of a defined period known as the *accumulation period*: see below. In the Crown Dependencies, this period is co-extensive with the Trust perpetuity period of 80 or 100 years, which is usually referred to in the Trust Deed as the *Trust period*. The Trust Deed may exclude the objects throughout this period from having any right to be informed that they are objects or (as noted above) to see Trust accounts. The trustees will usually also have wider powers to "appoint" income and capital out of the Trust so as to leave nothing on expiry of the Trust period. Arrangements that combine these features are commonly known as *blackhole trusts*.

12.2.7 In the UK, there is a *rule against accumulation* which requires that Trust income may not be accumulated after expiry of a 21-year accumulation period. There must, therefore, be existing beneficiaries, with a right to see the Trust

accounts, after expiry of that period. In the Crown Dependencies, there is no rule against accumulation and hence no requirement for there to be an existing beneficiary until the end of the perpetuity period.

12.2.8 Some Trusts are intended, not for persons with rights, but for *charitable purposes*. In this case, there needs to be an *Enforcer*, such as the Attorney General or Charity Commissioners on his behalf, who can enforce the Trust for the benefit of the charitable purposes. Such Trusts are of unlimited duration.

12.2.9 Jersey and the Isle of Man have recently brought in legislation (in the light of earlier Bermudan legislation) to permit *purpose trusts for non-charitable purposes* as well, such as promoting a political party or profession. Such Trusts are void in England and Guernsey. In Jersey and the Isle of Man they are limited to 100 years and 80 years, respectively. To be valid, they must have an Enforcer.

12.2.10 The Cayman Islands have taken the further step of bringing in new legislation for Special Trusts Alternative Regime *(STAR)* Trusts of unlimited duration whose beneficiaries can have no enforceable rights against trustees, enforcers or Trust property. In the Crown Dependencies, as in the UK, such Trusts would be ineffective. The beneficiaries, having no rights, would be regarded only as objects of a power, and the trustees would be regarded as holding the Trust property for the settlor.

### 12.3 Scale

12.3.1 Trusts are an important element in the Islands' international finance centres. A significant proportion of the total business involves the use of Trusts in one form or another. The Trust and company vehicles taken together enable them to offer a range of facilities not generally available outside the Anglo-Saxon jurisdictions.

13.3.2 The Islands, like the UK, do not register Trusts (other than regulated categories such as Unit Trusts). Hence the number of Trusts and the value of assets held in them are unknown. The Jersey authorities believe, however, that Jersey Trusts probably hold assets in excess of 100 billion. The Guernsey authorities believe that the corresponding figure for Guernsey may be 20 billion. A survey conducted in 1995 suggested that only one-quarter of the 26,000 Guernsey administered Trusts covered by the survey were for UK clients. The proportion has probably declined since then and will decline further as a result of the UK's tax avoidance measures announced in 1998.

### 12.4 Scope and purposes

12.4.1 In the Islands as elsewhere, Trusts are used for a remarkable variety of purposes. The main categories are family, charitable and commercial.

12.4.2 Within the *family* category, Trusts are widely used, among other things, as sophisticated forms of Will. They offer testators a wide range of possible benefits, including the ability:

- to have some continuing influence, through the trustees and the Trust Deed, over what happens to their assets after their death;
- to prevent the assets being squandered by lazy or spendthrift heirs or misused by mentally handicapped heirs;
- to keep assets or properties together rather than have them sold or dispersed into small parcels;
- to avoid forced heirship rules in various parts of the world;
- to avoid probate problems, which can be horrendous for persons with assets in several jurisdictions; and quite possibly
- to reduce tax liabilities.

12.4.3 Some offshore centres have introduced legislation to permit so-called *Asset Protection Trusts*, designed to improve protection for the settlor's assets against creditors, awards of damages or suits by estranged spouses. The Crown Dependencies, however, have no such legislation. The Island Courts would be expected to set aside Trusts designed to

prejudice foreseen creditors. With regard to unforeseen future creditors, the position is less clear (see below).

12.4.4 Within *charitable trusts*, the trustees may ask the Courts to authorise them to use the assets for closely similar purposes where the original purposes are no longer germane. Some commercial Trusts include a residual charitable element after other obligations have been met.

12.4.5 *Commercial* Trusts have been a notable growth area in the Islands as elsewhere. The major applications include:

- Pension Fund Trusts
- Employee share ownership Trusts
- Unit Trusts
- Debenture Trusts for bondholders
- Securitisation Trusts for balance sheet reconstructions
- Client account Trusts for lawyers and other providers of professional services, separate from the providers' own assets
- Future income stream Trusts
- Subordinated creditor Trusts
- Retention fund Trusts, pending completion of contracted work
- Sinking Funds.

12.4.6 In each of these cases, the Trust instrument offers the parties concerned a convenient solution to problems which would otherwise be highly intractable.

### 12.5 Special advantages of Island Trusts

12.5.1 Compared with the major onshore finance centres, the Islands are able to offer a favourable tax environment for Trusts and related vehicles:

- Non-resident Trusts (that is, Trusts with non-resident beneficiaries) do not pay income tax or any other tax in the Islands except on sources of Island income other than interest.
- Both non-resident and, except in Jersey, resident Trusts may gain from using the special Exempt Company (or, less often, International Business Company) tax vehicles, or equivalents, described in Chapter 10.
- Any resident Trusts that *are* subject to tax are taxed at 20 per cent on income but there are no capital gains or inheritance taxes.

12.5.2 As discussed in Chapter 10, substantial company structures owned by a Trust are quite common in the Islands. I was told that in Jersey perhaps 80 to 90 per cent of Trusts have corporate structures beneath them.

12.5.3 Where non-residents disclose details of their Trusts to their home authorities, the tax advantages will depend among other things on the tax regime in the home country. The UK introduced measures in 1991 and again in 1998 which largely remove any tax advantage for people resident or domiciled in the UK in having family Trusts overseas. Other countries have different tax regimes. For expatriates of most countries, the offshore Trust, company and banking facilities are likely to offer substantial advantages.

12.5.4 Other possible advantages the Islands may have compared with the main onshore centres are:

- the reassurance of having a visible and generally attractive Trust statute to supplement case law; and

- the availability of non-charitable purpose Trusts in Jersey and the Isle of Man.

12.5.5 Compared with other offshore centres, the Islands benefit from their reputation for competence, honesty and confidentiality. This must be attractive to those who wish to spread their risks between jurisdictions.

**12.6 Risks and abuses**

12.6.1 Hugely advantageous as Trust instruments can be, and important as they have been in the development of London and the Crown Dependencies as international finance centres, the risks too are considerable.

12.6.2 The vast majority of Trusts are doubtless free from abuses of any kind. But the scope for abuses is considerable. As Trusts age, moreover, the scope may multiply.

12.6.3 For offshore centres, above all, such abuses and the associated publicity could seriously damage reputations and business. In the Trust area itself, new business would be especially at risk. Most existing Trusts would probably remain in the Islands, since their trustees are mainly resident; but a protector may exercise a power to "export" a Trust by replacing the existing trustees with trustees from an alternative jurisdiction.

12.6.4 The risks of abuse in Trusts are of two main kinds: risks from crooked *settlors* and risks from crooked or incompetent *trustees*.

12.6.5 There are three main kinds of abuses that crooked settlors may attempt:

- *Concealment*. They may use Trusts and related company vehicles and bank accounts to conceal assets from creditors, estranged spouses, suitors or tax authorities. Or they may use Trusts, with their related companies and bank accounts, as elements in the elaborate processes for concealing the proceeds of crime of all kinds from police, customs, prosecutors and courts (money laundering).

- *Protection*. They may use Trusts to try to put their assets, even if discovered, beyond the reach of the same groups of pursuers: creditors, estranged spouses, suitors, tax authorities, police, customs, prosecutors and courts.

  To reinforce the protection given by the Trust itself, they may include in the Trust deed *"flee clauses"* providing that new trustees in a new jurisdiction with a new law will take over automatically when any of a specified range of events occur, such as prosecution of the former trustees or war in their territory. To facilitate this, they may arrange for the assets to be held in another jurisdiction again.

- *Sham Trusts*. They may seek an arrangement (which no reputable trustees would accept) whereby the trustees recognise that the assets remain the settlor's in all but name and that their task as trustees is to do exactly as the settlor says.

12.6.6 Also serious are the risks of abuses by *trustees*. The vast majority of trustees are doubtless honest, competent and conscientious. But those who are not may have scope for being dishonest or negligent without much risk of being found out. Potential abuses include:

- *Stealing*. Although settlors will usually set up the arrangements so as to minimise such risks, the trustees may be in a position to transfer assets from the Trust account or one of the companies owned by the Trust to their own accounts, or one of their own companies, either directly or (more probably) via other intermediate accounts. Such transfers will be easier if there is no obligation to keep and disclose audited accounts, either for Trusts or for companies. The truth may not come out until many decades later, when the Trust expires, and perhaps not even then.

- *Fees*. More simply and safely, the trustees may be in a position to bill the Trust fund for exorbitant fees or non-existent or unnecessary services. This too will be much easier if there is no obligation to keep and disclose audited accounts.

- *Negligence or incompetence over investments*. They may mishandle the investments, through negligence or

incompetence.

- *Failure to carry out the terms of the Trust deed*. Although liable to be sued, they may fail to carry out the terms of the Trust deed and/or the settlor's letter of wishes in the uses they make (or fail to make) of the Trust's assets.

12.6.7 As implied above, these abuses are much more likely to occur if the trustees are not properly *accountable* to anyone (as, for example, in the case of the "blackhole trusts" discussed earlier). There are two particular ways in which accountability may fail:

- *Non-disclosure to beneficiaries and objects*

  In most Trusts the beneficiaries or the objects of a discretionary power (as defined earlier) will have both the incentive and the locus to call the trustees to account. This is the principal and traditional means for ensuring that trustees act honestly, properly and competently.

  In most Trust jurisdictions, moreover, trustees will normally be required to tell beneficiaries that they are beneficiaries and to give them on request full and correct information about the Trust's assets.

  In some cases, however, some at least of the beneficiaries may not know that they are beneficiaries. Disreputable trustees may take the (limited) risk of failing to tell them or keep them properly informed about the Trust's affairs and assets and their stewardship of them.

  In other cases, no beneficiaries may be ascertainable until expiry of the Trust period and there may be power to accumulate income until then. In such cases there may be objects of a power who, under the terms of the Trust Deed, have no right to be told that they are objects of a power and no right to see the accounts even if they discover that they are objects of a power.

  In all such cases, the trustees may not be properly and effectively accountable to anyone, even though there is supposed to be accountability ultimately to some contingent beneficiary alive at the end of the Trust period. Especially once the settlor is dead, and the beneficiaries or objects are two or three generations removed from the settlor, the possibilities for abuse multiply.

- *No proper audited accounts*

  Trustees are always obliged to produce accounts for beneficiaries on request. But they may not be under any obligation to produce (or preserve) *audited* accounts or submit them to anyone unless the settlors have stipulated this in the Trust Deed.

12.6.8 In all Trust jurisdictions, the need to ensure proper accountability is paramount. Trustees should therefore be obliged, in my opinion, to make proper disclosures to beneficiaries and, as appropriate, objects of a discretionary power, and to produce, submit and preserve suitably audited accounts.

### 12.7 Existing legislation and regulation

12.7.1 In the course of my consultations, I found general agreement that, for the most part, the Islands have as good a legal framework for Trusts as any other jurisdictions, and better than most.

12.7.2 Despite some differences of history and substance, the framework is broadly similar to that in the United Kingdom. In Jersey and Guernsey, Trust Law has since the 1980s had a mainly statutory basis. Jersey's Trusts (Jersey) Law, 1984, has been widely copied in other jurisdictions. Guernsey passed a similar Trusts (Guernsey) Law in 1989, amended in 1990. The Isle of Man has a Trustee Act 1961, as amended, based on the UK's Trustee Act 1925, and the Courts apply case law from the UK and other countries.

12.7.3 In all the Islands, there have been significant legal cases concerning Trusts and fiduciary responsibilities. These have confirmed that the Islands' judiciaries are well qualified and able to deal with such matters.

12.7.4 As in the UK, the Trusts sector in the Islands is not at present subject to regulation or supervision. Individual

categories of business with a Trust dimension, notably Pension Funds, Unit Trusts and certain other kinds of investment business, are subject to the regulatory regimes for those areas. But there is no general regulation of Trusts or trustees.

# 13 COMPANY, TRUST AND PROFESSIONAL SERVICES PROVIDERS

### 13.1 Professional services providers in the Islands

13.1.1 As discussed in earlier Chapters, professional Trust and Company service providers play an even more important and prominent role in the business of the Islands' international finance centres than in the major onshore centres. They are, indeed, the drivers of much of the Islands' business, especially the Trusts and Companies business.

13.1.2 In Jersey and Guernsey, these providers are sometimes referred to collectively as "fiduciary service providers" or "fiduciaries". This reflects the fact that a large part of their activity consists in management of assets or businesses on a basis of trust for the benefit of others.

13.1.3 In the present absence of any regulatory system, the number and distribution of such providers is not known. But the Jersey authorities estimate that they have about 200 such providers, including 170 Trust or "managed" Trust companies (or groups of companies) and about 30 company formation and administration agencies which do not provide Trust services.

13.1.4 Guernsey appears to have 130 or more similar providers (new providers having been strictly limited since 1984) and the Isle of Man perhaps 400. The figures, however, are not necessarily comparable. Even if they were, the average size of provider may well differ between the Islands.

13.1.5 The *Trust service providers*, known in Jersey and Guernsey as Trust companies, mainly act as professional trustees but also provide other Trust-related services, including setting up Trusts and advice to clients.

13.1.6 Many banks, lawyers and accountants supply such services, usually through subsidiary Trust companies. There are also independent provider companies and partnerships.

13.1.7 The *company service providers*, sometimes known as company managers, administrators or formation agents, perform various functions in relation to companies, including company formation and sales, provision of registered office or accommodation addresses, company administration, and provision of Director services or Directors.

13.1.8 Some of them operate on an international basis, with branches in many countries. Whether or not they have such branches, they are able to arrange company incorporations in other jurisdictions as well as in the Islands.

13.1.9 Trust services providers often provide company services as well. As discussed in earlier Chapters, many offshore companies exist primarily as a convenient means of holding property, financial, business or other assets, and many Trusts have significant company structures beneath them.

13.1.10 Although sole practitioners are less common than they were, I understand that perhaps one-quarter of service providers in the Isle of Man, and perhaps one-tenth in Jersey and Guernsey, are still either sole practitioners or have only two or three staff in total.

### 13.2 Present legislation and regulation

13.2.1 As discussed in earlier Chapters, the Islands have a substantial volume of Trust and Company legislation and an established corpus of case law.

13.2.2 In addition, Control of Borrowing Orders and company registration procedures in Jersey and Guernsey enable the Island authorities to exercise some oversight over the formation of new Trust and Company service providers. Jersey and Guernsey have actively used this power. The Jersey authorities have also used their powers under the Regulation of Undertakings and Development Law to vet potential providers and impose prudential requirements. The Guernsey and Isle of Man authorities, too, have intervened from time to time, despite the absence of formal supervision, to vet potential providers.

13.2.3 That apart, there is at present no formal registration, regulation or supervision of such providers.

### 13.3 Island proposals to regulate service providers

13.3.1 In all the Islands, the authorities have plans to introduce such regulation:

- The *Jersey* authorities have announced plans to introduce a Fiduciary and Administration Business Law in 1999. This is intended to provide the basis for a comprehensive regulatory framework for Trust companies, company administrators, company formation agents and custodians.

- The *Guernsey* authorities have announced plans to pass new Laws as soon as practicable on (a) provision of Director services and (b) Fiduciary Business.

  As discussed in Chapter 11, the former is intended to provide a regulatory framework for supervision of those providing Director services by way of business, including Directors themselves.

  The latter is intended to bring the supervision of Trust companies, company administrators and professional executors within the statutory functions of the Guernsey Financial Services Commission. The providers would be required in all cases to be licensed. It would be an offence to carry on such business without a licence. The FSC would not have power to investigate client records but would be able to hire others to do so.

- The *Isle of Man* authorities have published proposals, including two detailed consultative papers, to introduce legislation early in the 1998/ 99 session to license and regulate corporate service providers (CSPs).

  These proposals are intended to cover all who provide by way of business company formation and selling services, Directors and professional secretaries, and registered offices and/or accommodation addresses. Only registered CSPs would be allowed to incorporate companies in the Isle of Man, except that Manx residents setting up companies for their own use would be exempted.

  The authorities have also indicated an intention to introduce similar legislation and licensing of Trust service providers but have set no timetable for this.

13.3.2 The Island authorities have all introduced separate legislation and regulation to deal with investment advisers and other investment service providers.

### 13.4 Case for regulation

13.4.1 In my opinion, the Island authorities are right to plan this extension of the regulatory boundary. The case for registering and regulating service providers is very strong. It rests on two main considerations.

- First, providers of these and related services seem to have been associated with a significant proportion of the disreputable business that has come to light in the Islands in recent years.

- Second, the most, and perhaps the only, effective way to regulate the large Trust and company sectors in the Islands is through regulation of the service providers.

13.4.2 Within the new policy, a key requirement will be to put the bad providers out of business. The authorities have not hitherto, in my opinion, done enough of this. In the course of my consultations with forensic accountants and others, and some study of Court cases, it became clear that a small but troublesome minority of company, Trust and professional service

providers, usually in collaboration with others outside the Islands, have been associated with disreputable business such as money laundering, fraud, false booking of profits and tax evasion. In some cases they may inspire such activities. In others, they may only facilitate them, either by colluding with master planners in other jurisdictions or by turning a blind eye.

13.4.3 Abuses of company and Trust vehicles are not, of course, confined to the Islands. Similar abuses are likely to be present in all jurisdictions.

13.4.4 In the major onshore jurisdictions, the authorities have not, so far at least, tackled these problems through regulation of company (or Trust) service providers. The circumstances, the legal frameworks and the balance of cost and benefit in regulation are all somewhat different from those of the Islands. It is to be hoped, however, that the larger countries may find equally effective ways to combat similar abuses in their jurisdictions.

13.4.5 Within the offshore, the British Caribbean territories license providers of company management services as well as Trust service providers.

### 13.5 Objectives for licensing and regulation

13.5.1 The objectives for licensing and regulation should closely reflect the reasons for introducing them. Above all they should reflect the need to find effective yet practical means for regulating the Trust and Company sectors, combating abuse of the Islands' facilities and ensuring that clients are well served.

13.5.2 The main specific objectives should be:

- to protect the Islands' clients by preventing fraud and other disreputable activity by providers;
- to promote high standards of business conduct and competence;
- to combat abuse of the Islands' Trust and Company facilities by customers wishing to launder money or commit other forms of crime;
- to ensure that providers do not promote, facilitate, collude in, acquiesce in or turn a blind eye to such abuses;
- to put the bad providers out of business; and
- by all these means, to protect the Islands' reputations.

### 13.6 Legislation and regulation structures

13.6.1 As indicated above, the Islands' proposals envisage somewhat different legislative structures, regulatory coverage and frameworks, and timetables.

13.6.2 In my opinion, a convenient structure is likely to be a single piece of overarching legislation, providing for the registration and regulation of all service providers, supported by specific Codes of Conduct for each of the main specific areas of business, notably:

Trust services
Company services
Director services.

13.6.3 The relevant Codes (or separate Codes) could also usefully set out what is expected of those fulfilling specialist roles such as Trust custodians, Trust enforcers, company secretaries, and compliance auditors.

13.6.4 Box 13.1 indicates what the broad provisions of the overarching legislation might be. This is a generalised version of the Trust services providers law sketched in Chapter 12.

13.6.5 The Codes of Conduct, similarly, might be along the lines set out in Chapter 11, Box 11.1, for Directors and in

Chapter 12, Box 12.2, for Trustees and Trust service providers.

13.6.6 The Code of Conduct for corporate service providers might be along the lines of Box 13.2. This is based on the proposals in the Isle of Man's Consultative Paper of November 1997 on The Licensing of Corporate Service Providers, with certain changes discussed below.

13.6.7 There is, of course, no absolute requirement to deploy the legislation and the Codes of Conduct in this way. But such a structure would seem to offer considerable advantages:

- *Coherence*. In each area of business, the basic requirements are similar. The FSCs are obliged to register providers, in accordance with "fit and proper" criteria, and to regulate them in accordance with the relevant Codes of Conduct. The providers are obliged to register themselves with the FSC, to conduct their businesses in accordance with the Codes of Conduct and to submit to regulation.

- *Simplicity*. A single overall legislative structure for regulation of service providers would seem to provide an easier and more familiar framework for the many providers who offer two or more different kinds of services than three or four separate laws.

- *Flexibility*. With overarching legislation and Codes of Conduct, the authorities would be able to add new Codes or change existing Codes in case of need without primary legislation.

- *Speed*. The authorities should also be able, with this structure, to deploy the regulatory regimes more quickly.

13.6.8 Further to the last point, it would seem very much in the Islands' interests to have the new registration and regulation systems in place as soon as practicable.

### 13.7 Main issues

13.7.1 The issues of substance that arise on these proposals include the following.

*(a) Strategy at introduction*

13.7.2 In any extension of regulatory boundaries, there is always a strategic issue as to how strict the authorities should be in the initial licensing round. There are two broad options:

- *Strictness*. The authorities set high standards from the outset and refuse to license questionable operators.

- *Leniency*. The authorities initially license all, or virtually all, the existing operators ("grandfathering") and hope to weed out later those who fall short. There are also of course a variety of intermediate options.

13.7.3 In my opinion, the case for strictness from the outset is overwhelming. The main considerations are:

- First, there is (as discussed earlier) an urgent short-term requirement to put bad or dubious operators out of business so as to prevent them from damaging customers or the Island.

- Second, it is arguably easier not to grant licences at the outset than to revoke them subsequently.

13.7.4 The leniency option, on the other hand, tempting as it may be in the short term, may not only fail to solve the immediate problems but also store up trouble for later.

13.7.5 The authorities must clearly be fair to providers both when introducing the new regulation and subsequently. Decisions which deprive people of their present means of livelihood should not be taken lightly. But the customers and the Islands' reputations must come first. The authorities cannot properly give the benefit of the doubt to providers of questionable fitness and propriety.

13.7.6 As discussed in the previous Chapter, the authorities will be well-advised to give due notice at the outset that the licensing criteria will be tough. Some of the less fit existing providers will then decide not to apply rather than be turned

down.

*(b) Requirement to use licensed providers*

13.7.7 If the Trust and Company sectors are to be successfully regulated through the professional service providers, it would seem that all Trusts and companies in the Islands, except perhaps for companies separately regulated by the FSCs or trading companies formed by residents to serve residents, should be required to have a licensed professional provider. At the very least, other equally authoritative local presences would need to be identified.

13.7.8 If Trusts and companies had an option to dispense with such providers, the regulatory system could be readily bypassed and would be ineffective.

*(c) Coverage*

13.7.9 The requirement for licensing or registration should clearly apply to all who provide Trust or Company services for customers of the Islands' finance centres. In particular, it should apply with no exemptions to providers:

- irrespective of whether they work in banks, accountancy practices, solicitors or advocates offices or other partnerships, or as independent practitioners;

- irrespective of their other professional qualifications (for example as lawyers, accountants, company secretaries or bankers); and

- irrespective of the size or scale of the enterprise.

13.7.10 For providers who work in institutions, the institution or the subsidiary that undertakes the service provider business would be subject to licensing. But it should be open to the FSC to require the institution to identify the staff members concerned and, in case of need, to debar them from taking part in this business.

13.7.11 In Guernsey, companies may only be formed by Advocates. This requirement has, indeed, provided a valuable sifting mechanism for company incorporations (though not company administrations). It will be for the authorities to decide whether this requirement should be retained or dropped under the new regime of licensing and regulation.

13.7.12 In Jersey, similarly, applications for incorporation of companies must be made by resident advocates or solicitors of the Royal Court or by accountants practising as principals in Jersey. The authorities propose under the new regime to allow only recognised businesses to make applications for incorporation and to require two signatures in support of the information supplied.

13.7.13 The requirement for licensing should clearly apply to small as well as large providers. Past experience indicates that some of the most serious problems have occurred with sole practitioners and small partnerships. The four-eyes requirement in the illustrative Code of Practice sketch would oblige existing single practitioners to merge if they wish to survive.

13.7.14 Providers who incorporate only a small number of companies each year should likewise be required to apply for licences. Here, too, the risks may be considerable.

*(d) Licensing versus notifying*

13.7.15 The authorities in all the Islands are now proposing a licensing system for providers of Trust and company services, or fiduciaries. This proposal seems right to me. A system of "notification" by providers, which the Guernsey authorities canvassed at an earlier stage, does not sufficiently convey the essential requirement for a system of licensed and regulated providers.

*(e) Beneficial ownership and shadow Directors*

13.7.16 In my opinion providers should be required to do all they reasonably can to establish the beneficial owners and shadow Directors of companies they incorporate or administer. If they cannot do this, they should not take on the business at all.

13.7.17 The Caribbean finance centres do not make this requirement. They allow providers to rely instead, if necessary, on the professional intermediaries who introduced the client. The British Virgin Islands Code of Practice (summarised at Box 13.1) requires providers only to take reasonable steps to ensure that a professional service client contracting a service on behalf of another client (the beneficial owner or his nominee) has adequate due diligence procedures in place.

13.7.18 The Isle of Man consultative paper suggests that providers should be deemed to have fulfilled their obligations if they have satisfied themselves that the professional intermediary overseas who has introduced a client has a good vetting system and would if necessary allow the provider access to the results.

13.7.19 In my opinion, it is less than satisfactory to delegate responsibility for due diligence in these ways. The better approach must be that stated at the beginning of this section.

*(f) Criminal and civil law*

13.7.20 The Isle of Man authorities have proposed that the legislation should create three criminal offences within the new regulatory boundary:

- acting as a provider without being properly licensed;
- knowingly or recklessly making false or misleading statements or providing false or misleading information to the Regulator; and
- obstructing the Regulator during a statutory investigation.

13.7.21 They have also proposed that Regulators should make maximum use of civil law procedures, not least for calling in administrators or liquidators to wind up businesses and for restraint and recovery of assets. As discussed above, the legislation needs to give the authorities a clear locus to use such procedures.

13.7.22 In my opinion, the Isle of Man proposals in this respect are entirely right.

*(g) Sanctions and Appeals*

13.7.23 Apart from the above powers, the Isle of Man authorities propose, rightly in my view, that the main sanctions should be:

(i) withdrawal of operating licenses, and

(ii) fines, at levels to be fixed from time to time in subordinate legislation.

13.7.24 The fines need preferably to be fixed so that providers guilty of disreputable activity stand to lose more than they would have gained had their crimes, or regulatory breaches, not been detected.

13.7.25 As all the Island authorities have acknowledged, an Appeals procedure will also be needed.

*(h) Active enforcement*

13.7.26 The consultative papers of the Isle of Man and Guernsey authorities proposed that enforcement of the new regulatory regime should be reactive only, not proactive. The authorities would only respond to complaints or other adverse information. There would be no compliance visits.

13.7.27 In response to the consultation process, however, the Isle of Man authorities have decided that enforcement must be proactive as well as reactive.

13.7.28 In Guernsey the authorities have not proposed to take powers to send in their own staff on compliance visits. The FSC's Director General would, however, be able to order investigations by duly qualified persons.

13.7.29 In Jersey, by contrast, the authorities have decided in principle to include in the legislation powers to send in FSC staff on compliance visits. Use will also be made of external auditors, for example to verify returns made by registered persons.

13.7.30 In my opinion unenforced regulation, and even reactively enforced regulation, are likely to be honoured in the breach rather than the observance. As many respondents to the Isle of Man's earlier consultative paper argued, therefore, it seems essential to undertake a sensible measure of proactive enforcement, including some on-going inspection of the licensed population. It will be no less important actively to police the "perimeter" of unlicensed business.

13.7.31 I sense that opinion in all the Islands has now moved, or is moving, in favour of a sensible degree of proactive as well as reactive enforcement. This seems to me entirely right. I hope, too, that the FSCs will all have powers to use their own staff as inspectors or investigators as well as outsiders.

*(i) Capital adequacy and Professional Indemnity and Employee Fidelity Insurance*

13.7.32 If providers fall down for any reason in the services they provide, the client's practical access to redress will depend importantly on the provider's capital base, professional indemnity insurance (to cover mismanagement and incompetence) and employee fidelity insurance (to cover fraud by staff within the provider's own organisation).

13.7.33 The Isle of Man authorities have proposed that providers should be required to certify each year that they are able to meet their liabilities as they fall due.

13.7.34 In my opinion, the Codes of Conduct should also oblige providers:

- to maintain adequate capital resources;
- to maintain professional indemnity and employee fidelity insurance at levels that are adequate in terms of amounts and coverage; and
- to disclose these matters in appropriate terms to their clients in their initial client agreements and to inform them subsequently of any major changes.

The broad principles of "adequacy" would best be defined in an Annex to the Code of Conduct.

*(j) Internal controls*

13.7.35 The illustrative Code includes a number of provisions relating to internal management and controls, including the four-eyes principle, rigorous separation of client and provider funds, audited accounts and an annual compliance audit. These are none the less important for being familiar.

*(k) Resources*

13.7.36 Effective regulatory regimes for service providers will be quite resource-intensive. If the authorities opt for a strict initial licensing round, as recommended above, the requirement for staff is likely to be especially great in the early stages of preparing and introducing the new regime.

13.7.37 For these reasons, the Chapter 6 discussion on staff requirements assumed that each of the FSCs would need between four and seven staff in the early stages.

13.7.38 The choice of staff will also be important. As discussed earlier, regulatory regimes on the lines envisaged here are not yet found in the major onshore centres. So there will be no international pool of staff with precisely relevant experience. But it should be possible to build up effective teams including people with experience of company, legal and accountancy regulation, and of compliance and anti-fraud work, as well as some former practitioners.

# 14 FINANCIAL CRIME AND MONEY LAUNDERING: POLICY AND LEGISLATION

### 14.1 The Islands' policies

14.1.1 The authorities in all the Islands have made clear their firm commitment to prevent, deter and combat crime of all kinds, wherever committed, including money laundering and tax evasion as well as drug trafficking, terrorism and fraud. They are likewise committed to the fullest co-operation with other jurisdictions to that end.

14.1.2 The Island authorities' commitments in these areas are of the highest importance. Effective policies for combating financial crime are clearly essential in any international finance centre of repute. Within such policies, moreover, co-operation with overseas authorities is increasingly a central element. Such co-operation depends critically on having the will to help as well as good legislation and adequate resources for implementation.

### 14.2 Compliance with FATF and other international standards

14.2.1 In pursuit of the commitments discussed above, all the Islands have a policy to comply with the Forty Recommendations on combating money laundering of the international Financial Action Task Force (FATF), revised in 1996. FATF members include Government and law enforcement representatives from all the countries with major financial centres in Europe, North America and Asia.

14.2.2 Expert groups of officials from the UK and Holland found in 1994 that the Islands were well on the way to compliance with the Forty Recommendations. Since then, further progress has been made. New mutual evaluation groups, including experts from FATF countries, are due shortly to assess whether full compliance has been achieved.

14.2.3 Through the United Kingdom, the Isle of Man is already a party to the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime. Jersey and Guernsey will be in a position to be parties to the Convention when they have completed passage of their legislation on all crimes money laundering and international co-operation.

14.2.4 Jersey and the Isle of Man are both parties to the 1988 Vienna Convention against Illicit Trafficking in Narcotics. Guernsey expects to be a party during 1999.

14.2.5 All the Islands are also associate members of the UK's Financial Fraud Information Network, FFIN, set up in response to the Bingham Report on BCCI, and participate in the Shared Intelligence Service database co-ordinated by the Financial Services Authority.

### 14.3 Types of crime

14.3.1 On the basis of my researches and consultations, I have no doubt that most of the Islands' business is perfectly legal.

14.3.2 Inevitably, however, the Islands face challenges similar to those of other finance centres, both offshore and onshore, in the field of financial crime and money laundering:

- Customers may abuse the facilities of any finance centre to facilitate international financial crimes such as drug trafficking, terrorism, fraud, theft, insider trading, illegal flight capital, corruption and tax fraud and evasion. All

such crimes may be organised either by criminal groups ("organised crime") or companies or individuals.

- Customers may use the financial institutions, Trusts and companies of any finance centre to hide the proceeds of these and other kinds of crime and make them appear respectable. Such customers, who may again be individuals or companies or organised crime units, typically move money from one centre to another in long trails designed to confound investigators. This is the process now known as "money-laundering".

- Customers of any finance centre may deposit "grey" money there. The ultimate source of such money may be obscure. Its legality may be questionable rather than clear. Or it may have nothing to do with crime in any generally recognised sense but be illegal within the extreme laws of some repressive regime.

- From time to time, practitioners in any finance centre may defraud or otherwise let down the centre's customers.

14.3.3 In the Islands, as elsewhere, the extent of disreputable business is hard to judge.

14.3.4 With regard to money laundering, there is little doubt that offshore centres generally, and likewise onshore centres with large amounts of non-resident business, are liable to receive substantial amounts of laundered funds as criminals seek to conceal their tracks by moving the proceeds of crime through a number of separate jurisdictions. It would not be surprising if the Islands, with their excellent range of banking, Trust, investment, insurance and company facilities, were prone to suffer in the same way as other centres in these categories, not through any fault of their own.

14.3.5 There are three indications which seem to confirm this:

- First, the authorities in the onshore jurisdictions whom I was able to consult about this had no doubt, based on their own experience of cases, that money launderers do make considerable use of offshore jurisdictions, including the Islands.

- Second, the authorities in the Islands receive many more requests from other jurisdictions for assistance in the pursuit of money laundering and other crimes than they make themselves. Since the vast majority of the world's crimes take place outside the Islands, this is hardly surprising. There is also an implication that the Islands are among the jurisdictions through which some of those who commit crimes outside the Islands try to launder the proceeds.

- Third, as discussed in the next Chapter, the number of suspicious transactions reported to the Island authorities is comparatively high. This too may suggest that some criminals elsewhere try to launder money through the Islands, though it may reflect just as much the success of the Islands' suspicion reporting systems and their policies to combat money laundering.

14.3.6 It has been put to me that, where money laundering occurs, the Islands are mainly used as staging posts in the later, "layering" stages of laundering trails, when money is passed from one jurisdiction to another in order to obscure its origin. The initial "splash" or "placement" stage, when the proceeds of crime are first deposited in the financial system, is more likely to take place in the onshore jurisdictions where, inevitably, most of the crime takes place.

14.3.7 This seems to me very likely to be true. It is consistent with the fact that the Islands receive many more requests for assistance than they make.

14.3.8 Whether the Islands receive large amounts of laundered money relative to other offshore centres (or indeed to onshore centres with much non-resident business) is another issue again. The conventional wisdom is that money launderers prefer to use secure and respectable jurisdictions wherever possible. From this point of view the Islands must be attractive. On the other hand, my impression is that the Islands' systems for combating money laundering are well in advance of most other offshore jurisdictions, are probably at least as good as those of most onshore jurisdictions and are improving all the time. I would therefore expect money launderers to be increasingly wary about using the Islands' facilities.

14.3.9 With regard to tax fraud and evasion, the limited exchanges of information between the world's tax authorities make any assessment of scale more than usually hazardous. Several practitioners on the Islands told me that they were unaware of any such activities. To judge by discussions I have had with forensic accountants, however, and some cases I have studied, it is difficult to do otherwise than conclude that in the Islands as in other offshore (and some onshore) jurisdictions there continues to be a significant amount of such business, not confined to UK tax evasion, possibly associated with a small

minority of firms and practitioners.

14.3.10 The schemes used to facilitate evasion of corporate taxes in other jurisdictions include booking of inflated profits to companies in the Islands, sometimes achieved by sales of fictitious or overpriced services by such companies to a connected company in the other jurisdictions. To judge by reported cases, such schemes seem typically to be devised in tandem by practitioners in the two jurisdictions. Section 13.8 mentions one such case. Schemes for evasion of personal income, capital gains or inheritance taxes, on the other hand, seem typically to depend more simply on non-reporting by residents of other jurisdictions of income received or assets held on the Islands.

14.3.11 Illegal forms of flight capital are equally hard to assess. In the Islands as in other international centres, both offshore and onshore, some of the assets held by non-residents with the Islands' institutions are likely to be either illegal or of questionable legality in the country from which the assets have been transferred. Whether the Islands have proportionally more or less than other centres is impossible to say, though the institutions I visited seemed to me to pursue commendably cautious policies and to be punctilious in the exercise of due diligence.

14.3.12 The BCCI collapse may offer some clue as to the possible scale of disreputable business among the customers of one bank in one of the Islands. About one-third of potential claims on the liquidator from customers of BCCI's Isle of Man branch did not materialise. The corresponding proportion for customers of BCCI branches in the UK was 45 per cent. The claimants concerned seem to have thought it worth their while to forswear compensation of up to 15,000 in the Isle of Man, or up to 18,000 in the UK, in order to hide their identities. Not all of them were necessarily evading tax or other overseas regulations. But many of them probably were. As the wider BCCI saga has revealed, however, BCCI branches in general are likely to have had a much higher proportion of disreputable business than other financial institutions and cannot be assumed to be typical.

14.3.13 The presence of some illegal business in the Islands, inevitable as it is, has to be kept in perspective. As discussed above, all international centres are liable to attract some such business. In my opinion, the Islands probably suffer less in this way than most other offshore centres. There are, moreover, solid grounds for thinking, as suggested earlier, that most of the Islands' business is perfectly legal:

- First, there are many perfectly good and legal reasons, including tax planning, why customers across the world may choose to use the Islands' facilities. Chapter 2 listed some of these.

- Second, as discussed later in this Chapter, the Islands have introduced or are introducing a formidable arsenal of legislation, with accompanying enforcement resources, to combat financial crime and money laundering. This must be making the Islands less attractive to criminals and money launderers.

- Third, the Islands' firms and institutions mostly take great pains to vet and select incoming business. As they have pointed out to me, they have the keenest commercial interest in avoiding illegal or questionable business which could involve them in costly litigation or reputational risk.

14.3.14 That said, the Island authorities fully accept that, like other international finance centres, they cannot afford to be complacent about abuse of their facilities by criminals. They also accept that in their role as hosts of international finance centres they have an absolute obligation to minimise such abuses.

## 14.4 Development of legislation

14.4.1 The Islands have developed considerable arsenals of legislation to combat financial crime of all kinds. It is mostly based on, though not identical to, UK legislation.

14.4.2 As in the UK, financial institutions and professionals in the Islands continue to have a common law duty of client confidentiality (though there are no banking or other secrecy laws). But the Courts have long had powers to override this duty in the pursuit of crime and the recent legislation mentioned above has further enhanced the ability of the authorities to do so.

14.4.3 The Islands have long had legislation to combat *fraud*. Guernsey and the Isle of Man also have *theft* legislation, while Jersey relies on the common law of larceny.

14.4.4 The Islands are able and willing in some cases to assist overseas authorities through participation in Mutual Legal Assistance Treaties (MLATs) between the UK and other countries. In other cases, they are willing to give the same assistance as would be provided under an MLAT.

14.4.5 In recent years the Islands have added to their arsenals *money laundering* legislation on UK lines in relation to *drug trafficking and terrorist offences*. This enables the authorities:

(a) to *trace, seize, restrain and confiscate the proceeds* of drug trafficking and terrorism, and

(b) to institute obligatory systems of *suspicious transaction reporting* by financial institutions, companies and professionals while also protecting them against liability under the common law duty of confidentiality.

14.4.6 By the end of this year, the Islands will all have "*all crimes money-laundering*" legislation, again on broadly UK lines, giving the authorities powers similar (but not identical) to those at (a) and (b) above in relation to the proceeds of crimes of all kinds, including fiscal offences.

14.4.7 Alongside their fraud and money laundering legislation, the Island authorities have either taken or intend to take two more general sets of powers:

(a) *powers to obtain information needed for investigations* and judicial *evidence*, through such means as production orders and search and seizure warrants, for use both in their own investigations and prosecutions and to assist those of other countries; and

(b) *international co-operation* powers to obtain information, documents and evidence for use by Courts and investigating authorities outside the Islands and to assist in the forfeiture orders of overseas Courts.

14.4.8 The UK model for (a) above is the Police and Criminal Evidence Act (PACE) 1984. The UK model for (b) is the Criminal Justice (International Co-operation) Act 1990.

14.4.9 Also relevant to the combating of financial crime in the Islands, including money laundering, are the Islands' legislation on financial regulation, companies, trusts, insolvency and bankruptcy, the forthcoming legislation on corporate and trust service providers, and the Double Taxation Agreements with the UK. Good legislation and regulation in these areas can contribute greatly to the prevention and pursuit of crime.

14.4.10 In summary, therefore, the Islands have either completed or will soon complete an arsenal of legislation on financial crime and money laundering similar (but not identical) to that of the UK. As discussed below, the Isle of Man has largely completed it already. Jersey and Guernsey plan to complete it by the end of 1999.

### 14.5 Issues arising on existing legislation

14.5.1 For the most part, the Islands' existing legislation seems to work well. In relation to drugs and terrorist offences, in particular, the authorities in all the Islands have been able to give exemplary assistance to the investigating and prosecuting authorities of other countries.

14.5.2 As discussed in the next Chapter, the hitherto incomplete state of the legislative arsenal has hindered the Islands' ability to give assistance in other areas (though the Isle of Man has had full powers to assist other jurisdictions with investigations and evidence since the Criminal Justice legislation of 1990 and 1991). But that problem should largely disappear when Jersey and Guernsey enact the three outstanding laws mentioned above. The authorities in both Islands, rightly in my view, are now attaching high priority to this and have set a firm objective to have the legislation take effect by the autumn of next year.

14.5.3 The legislation that exists or will shortly exist in the Islands, like that in the UK, includes a wider definition of money laundering than that of most onshore jurisdictions, not least in including fiscal offences. It also deals more comprehensively with assistance to other jurisdictions and the reporting of suspicious transactions. Within it, however, there are a few problem areas, actual or potential, which merit further consideration. These relate partly to the legislation itself and partly to the policies of the Island authorities in implementing it.

*(a) Restriction of co-operation under all crimes money laundering legislation to locally indictable offences or offences carrying a maximum sentence of not less than one year*

14.5.4 The new all crimes money laundering legislation in the Islands, which empowers the authorities to assist overseas authorities over searches, seizures and restraint or confiscation of assets, broadly follows the UK legislation in the definitions of criminal conduct in relation to which assistance may be given.

14.5.5 The Guernsey legislation, like that of the UK, empowers the authorities to give this assistance in cases where the conduct involved in the predicate crimes would be indictable if committed in the home jurisdiction.

14.5.6 In the Isle of Man, the authorities have powers to give assistance both where the offences concerned would be "triable on information" if committed in the Island and in relation to hybrid offences which can be tried either summarily or on information. Offences triable on information are offences with a maximum sentence of 6 months or more and are roughly equivalent to indictable offences in the UK. The authorities have a power, moreover, like the UK authorities, to prescribe additional offences which will constitute criminal conduct for the purposes of the legislation.

14.5.7 In Jersey, where there is no distinction between indictable and summary offences, the proposal is to limit co-operation to offences carrying a maximum sentence of not less than one year, again with a power to prescribe additional offences as necessary.

14.5.8 As a matter of principle, co-operation should preferably not, in my opinion, be limited to the proceeds of offences which if committed locally would be indictable (or offences with a defined maximum sentence). The message this gives to the criminal is that offences treated locally as summary offences (or offences beneath the sentence threshold) can be committed with impunity.

14.5.9 How important such limitations are in practice depends on what offences are locally indictable (or what penalties are prescribed for particular offences). In the Crown Dependencies as in the UK, it appears that the limitations will not in practice impede co-operation:

- In Guernsey, virtually all offences are indictable.
- In the Isle of Man, the main definition covers all serious crime and there is, as already discussed, a power to prescribe additional offences where co-operation may be given.
- In Jersey, all customary law offences including larceny, embezzlement, false accounting and fraud (including fiscal cases) carry maximum penalties of more than a year and will therefore be covered. Here too, moreover, there is a power to prescribe additional offences.

14.5.10 The limitations do, however, leave areas of uncertainty, not least in relation to tax evasion cases. I have read a number of Counsel's opinions, relating both to the UK and to one of the Islands, which suggest that various kinds of tax evasion would not or might not be caught by the legislation. Local guidance to practitioners on at least one of the Islands draws on these opinions.

14.5.11 In other offshore centres, moreover, such limitations may exclude co-operation on most fiscal offences (which tend to be summary offences) and all offences concerning specific taxes, such as inheritance and capital gains taxes, that do not exist in the centres. Experience in some of these centres suggests that the limitations may lead to serious loopholes.

14.5.12 The only potential justification for such limitations is pressure on resources. The UK and other authorities probably feared that, without some limitation, they would be inundated with requests for assistance which they would not have the resources to handle. The Islands have followed the UK's lead. But the reality is that no overseas jurisdictions are so well-resourced that they will pursue insignificant cases.

14.5.13 For all these reasons, it would be much better, in my opinion, not to limit international co-operation in this way, even though such limitations are widespread in FATF and other jurisdictions.

14.5.14 Ideally all countries would agree to drop the limitations. Failing that, voluntary action to drop them by jurisdictions wishing to co-operate to the fullest extent in the pursuit of crime seems to me preferable to ritual insistence on a level

playing field (which all too often means adopting the lowest available international standard).

14.5.15 If the UK takes the opportunity to change its legislation in this way, therefore, or to add to the schedule of non-indictable offences where co-operation can be given, I hope that the Islands will follow suit. In the meantime, I hope that the Jersey authorities will, if only for the sake of appearances, either abolish the one-year maximum penalty criterion or reduce it to six months.

*(b) Crime definition thresholds*

14.5.20 A similar problem arose until recently on the Jersey authorities' interpretation of their fraud legislation.

14.5.21 This legislation applies, as in the UK and the other Islands, to cases of "serious or complex" fraud. The Jersey authorities interpreted this as meaning frauds, actual or suspected, involving amounts of 2 million or more. They adopted this figure on the basis of the 2 million figure initially set by the Serious Fraud Office (SFO) in the UK to distinguish cases which the SFO would consider taking over from local Fraud Squads.

14.5.22 The practical effect has been that, in cases of suspected fraud, the Jersey authorities have limited their co-operation with the authorities of the UK and other countries to cases involving amounts above 2 million, while sometimes being prepared to assist in smaller cases considered serious or complex.

14.5.23 In my opinion, it is not good practice to limit co-operation in the pursuit of crime to cases thought to involve sums of money above a defined threshold such as 2 million (which incidentally excludes most fiscal offences). Such a policy also risks giving the wrong messages to would-be criminals. It leaves an impression that frauds of less than the defined amount will not be investigated. It also encourages 'smurfing'. As discussed above, the only justification for such limitations would be pressures on resources. But overseas jurisdictions are not in practice so well-resourced that they will pursue insignificant cases.

14.5.24 For reasons such as these, the Jersey authorities have now scrapped the quantitative threshold altogether. I am sure that they are right to have done so.

14.5.25 The authorities have told me that they propose in future "to consider each case on its merits as to whether it constitutes serious or complex fraud". I hope, however, that they will also set a firm presumption in favour of assisting overseas authorities in the investigation of any frauds which the latter authorities consider to be serious or complex, while of course reserving the right, in this as in other areas, to withhold assistance in particular cases on wider public policy grounds.

*(c) Fiscal investigations*

14.5.26 The Jersey authorities have also had a policy not to assist *investigations* by overseas authorities in purely fiscal cases, though the fraud powers mentioned above would in principle provide the necessary powers to assist on a similar basis as for other kinds of fraud. The Royal Court is willing, on the other hand, to meet applications to assist in the provision of evidence in fiscal cases where criminal proceedings have begun.

14.5.27 The Jersey authorities have now said that they *will* be prepared in future to use the powers they have under their fraud law to investigate fiscal crimes which can be regarded as serious or complex fraud.

14.5.28 For the period immediately ahead this seems to me a constructive proposal, especially if the practical interpretation of serious and complex fraud is changed in the way discussed in the previous section. The Police and Criminal Evidence (PACE) and International Co-operation legislation, which both Jersey and Guernsey propose to enact by the autumn of 1999, will provide a fuller and more permanent solution.

14.5.29 Some of the onshore authorities whom I consulted, not just in the UK, spoke of a need for improved co-operation by offshore centres generally, including the Islands, in relation to fiscal offences. Now that the legislative arsenals are complete, or nearing completion, I hope that the authorities in all the Islands will ensure that co-operation works as well as possible in this as in other areas.

*(d) Restraints on sharing suspicion reports outside the Island*

14.5.30 The new all crimes money laundering legislation in the Isle of Man and Jersey permits the police to disclose information obtained through the suspicious transaction reporting system to people outside the Island only with the Attorney General's consent.

14.5.31 In principle this requirement could result in damaging delays in the transmission of information and troublesome increases in the workloads of the Attorney Generals. However, the Attorney Generals in both Islands propose to issue general consents which will permit the police to pass information to defined recipients without specific individual consents.

*(e) Time-bars for prosecution*

14.5.32 As highlighted by the recent Bank Cantrade case, Jersey has a Miscellaneous Provisions Law, 1978, which requires that the prosecution of most statutory offences must be brought within 3 years of the date when the alleged offences were committed. This time-bar meant that, even if the authorities had considered that the evidence justified it, there was no option to prosecute one of the bank staff involved in the case.

14.5.33 The Jersey authorities are recommending to their Parliament, rightly in my view, that all such time-bars to prosecution should be repealed.

# 15 FINANCIAL CRIME AND MONEY LAUNDERING: PRACTICALITIES

## 15.1 Overview

15.1.1 This Chapter considers how the Islands' systems work in practice to combat financial crime of all kinds, including money laundering and tax evasion. It looks first at areas of special interest to overseas authorities pursuing crimes:

intelligence
investigation
obtaining evidence
tracing, restraint and confiscation of assets
extradition

and then at domestic prosecutions, convictions and penalties.

15.1.2 The overseas authorities whom I consulted were agreed that the Island authorities have been notably successful, as well as helpful, in the pursuit of drug trafficking and customs and excise offences, and not only in these areas. Where problems have arisen, they have mainly been in other areas.

## 15.2 Intelligence: suspicion reporting systems

15.2.1 The Island authorities recognise that good intelligence is all-important in the pursuit of crime, as is the exchange of intelligence with overseas authorities. Anti-money- laundering policies, in particular, depend on this.

15.2.2 In keeping with best international practice, therefore, as set out in the FATF's Forty Recommendations, the Island authorities have introduced systems of suspicion reporting by the financial, professional and company sectors. The systems are modelled on the UK's system.

*(a) Duty of confidentiality*

15.2.3 As discussed in Chapter 14, information on customer finances held by the financial and professional sectors in the Islands continues, as in the UK, to be protected by a common law duty of confidentiality. The Courts have long been able to override this duty for the purposes of criminal investigations or proceedings. The new legislation defines further circumstances where the duty is overridden:

- The drug trafficking and counter-terrorist legislation obliges financial institutions, companies and professionals, as in the UK, to report to the authorities transactions which they know or suspect are related to these forms of activity. It also protects the staff concerned from being sued for breach of confidence.

- The new all-crimes money laundering legislation (or related legislation) will shortly extend the reporting obligation and the protection for staff, as in the UK, to transactions which institutions and staff know or suspect are associated with crimes of *all* kinds, including tax evasion. It will shortly be an offence for staff not to report such transactions to the authorities.

15.2.4 The Island authorities to whom these suspicion reports must be made are the joint Police/Customs Financial Investigation Units in Jersey and Guernsey and the Police's Fraud Squad in the Isle of Man. They in turn are obliged to treat

these reports in confidence.

*(b) Obligations of reporting organisations*

15.2.5 In all the Islands, the Police authorities have gone to considerable lengths, in co-operation with the Financial Services Commissions and bodies representing the industries, to ensure that reporting organisations and individuals understand their obligations and their duty of vigilance under the new legislation for reporting of suspicions. They are required:

- to have suitable internal compliance systems and procedures;
- to determine the identity of customers or potential customers;
- to recognise suspicious transactions or activities and report them to the authorities;
- to keep records for prescribed periods;
- to identify and train reporting officers and key staff;
- to keep in touch with the authorities and the FSCs;
- to arrange for regular monitoring of their arrangements by internal auditors and compliance units.

*(c) Coverage of crimes: tax evasion*

15.2.6 The new legislation governing the suspicion reporting system, like that of the UK, covers the proceeds of all locally indictable crimes (or, in the case of Jersey, all crimes with a maximum sentence of one year or more). Chapter 14 discussed the disadvantages of these formulations.

15.2.7 As in the UK, locally indictable crimes include tax offences. Finance sector staff are or will be obliged, therefore, to report suspicions of tax offences, wherever committed. In the United States, Ireland and Finland, similarly, reporting bodies are obliged (under separate legislation in the US) to report suspicions of tax evasion as well as other crimes. In most of the European countries, on the other hand, the banks and other reporting bodies are not, as yet, obliged to report suspicions of tax evasion.

15.2.8 In my opinion, the Islands are right to include tax evasion and other tax offences within the transaction reporting system, as in the UK and the US. Not only is there no significant moral distinction between defrauding the tax authorities and defrauding anyone else. But excluding tax evasion from the predicate offences covered by the suspicious transaction reporting system gives the perfect alibi to institutions or staff disinclined to report suspicions. They can excuse failures to report by saying that they assumed the offences to be tax evasion.

15.2.9 Reporting institutions and staff are obliged only to report their knowledge or suspicions to the Island authorities. They are not obliged to be expert in criminal or tax laws throughout the world. They will seldom know what crimes, if any, have been or are being committed. Neither is it for them to judge whether suspicions concerning non-residents should be reported to the authorities of the countries concerned. These are matters for the authorities to investigate and decide.

*(d) Institutional coverage, including companies, professionals and bureaux de change*

15.2.10 In the Islands, as in the UK, the obligation to make suspicion reports extends to all categories of financial institution, trust companies, other companies, lawyers, accountants, investment advisers and other partnerships and individuals. There is a limited exemption for information covered by legal privilege.

15.2.11 In my opinion, this comprehensive coverage must be right. In many countries, however, including the US and France, lawyers and accountants are not yet obliged to report.

15.2.12 Among the bodies covered by the new reporting obligations are the Islands' *bureaux de change*. Like other bodies, these bureaux are required to have appropriate compliance systems as well as making reports.

15.2.13 The Islands have many fewer such bureaux than (say) Gibraltar. As in the UK, they are not subject to regulation by the Islands' FSCs because they are simply traders in currencies and do not take deposits, conduct investment business for clients or undertake any other forms of fiduciary responsibility.

*(e) Levels of reporting*

15.2.14 In all the Islands, even ahead of introduction of the All Crimes Money Laundering legislation, the level of suspicion reporting has been impressive. The new system has led to a step-jump in the quantity and quality of intelligence.

15.2.15 As indicated in the accompanying table, the Island authorities received 1670 suspicion reports in 1997. This is an impressive figure, which compares with only some 13,000 in the UK (excluding reports from the Islands). In a small but significant minority of cases, suspicious transaction reports lead to discoveries of money laundering or other crimes.

15.2.16 The table at Box 15.1 shows the number of reports made by each group in 1997 in the three Islands taken together.

15.2.17 As the table indicates, the vast majority of reports have come from banks, though life insurance companies too have made a large number and trust companies a significant number. Reports by other groups have so far been limited. The implication seems to be that the reporting systems are working well in banks and insurance companies but less well in other areas.

**BOX 15.1-Suspicious Transaction Reports in the Three Islands**

| *Institution* | *Number of reports, 1997* |
|---|---|
| Banks | 1,231 |
| Insurance companies | 366 |
| Other financial institutions | 7 |
| Trust companies | 35 |
| Other companies | 3 |
| Lawyers | 2 |
| Accountants | 9 |
| Investment advisers | 2 |
| Other partnerships and individuals | 15 |
| TOTAL | 1,670 |

15.2.18 Especially troublesome, perhaps, are the small numbers of reports made by lawyers and accountants and by companies other than financial institutions and trust companies.

Reports from these bodies may increase when the reporting regime is extended, as it shortly will be, to cover all crimes. For the time being, however, the numbers seem very low.

The authorities propose, therefore, rightly in my view, to target education and training programmes on these groups.

*(f) Feedback*

15.2.19 The Island authorities are well aware of the need to provide feedback to the provider institutions. It is clearly important that they should do so.

*(g) Sharing of information*

15.2.20 The Guernsey and Isle of Man authorities feed all their suspicion reports into the NCIS database in London. The Jersey authorities have in the past fed in only reports where NCIS have given a positive initial response but propose to bring their practice into line with that of the other Islands.

15.2.21 With advancing technology for communications and money transmission and the globalisation of crime, intelligence professionals need to be able to share intelligence quickly and in confidence with counterparts in other countries. As discussed in Chapter 14, the Island authorities mostly have a good record in this and have taken steps to remove unnecessary obstacles

**15.3 Intelligence: other aspects**

15.3.1 The suspicion reporting schemes enable the authorities to build up information databases which are invaluable in the pursuit of crime of all kinds, not just financial crime. Other sources, however, are important as well.

15.3.2 One such source is companies data. As discussed in Chapter 10, Jersey and Guernsey collect information on the beneficial ownership of companies registered in the Islands though not of other companies operating on the Islands. Its value would be much increased if the proposals discussed in Chapter 10 were implemented.

15.3.3 Another valuable source is information from members of the public. To facilitate this, the Islands have public "crimestopper" lines to the police. There may be a case for a specific "financial crimestopper" line to the Islands' Financial Investigation Units or Fraud Squads.

**15.4 Investigation**

15.4.1 When the authorities have intelligence that a crime has or may have been committed but do not have enough information to bring charges, they need to make investigations. This "investigation stage" often requires co-operation by other authorities both inside and outside the jurisdiction.

15.4.2 As discussed in Chapter 14, the Island authorities receive many more requests for help with investigations than they make themselves. In all cases they believe that they provide a better service to others than others provide to them. The paragraphs which follow discuss some problems that have arisen at the investigation stage.

*(a) Deficiencies of legislation*

15.4.3 As discussed in Chapter 14, a significant problem in Jersey and Guernsey has been that the legislation empowering the Islands' police authorities to make investigations and assist other countries has hitherto been patchy and deficient. This has sometimes put the police in a difficult position. They have not always had the powers to give the authorities in other countries the help they would have liked to give.

15.4.4 As noted before, the Isle of Man authorities have had international co-operation legislation in place since early in the decade and have now completed the other elements in their legislative arsenal for co-operation. The Jersey and Guernsey authorities expect to complete theirs by the autumn of 1999.

*(b) Policy stances*

15.4.5 The Island authorities have repeatedly affirmed and demonstrated their willingness to help. In Jersey, the authorities' earlier policies of not helping in fiscal cases and limiting assistance on fraud to cases above 2 million have been a significant problem. As discussed in Chapter 14, however, the authorities have now reversed these policies.

*(c) Different kinds of investigating authority*

15.4.6 The authorities in certain onshore jurisdictions told me that they have difficulty in co-operating with different kinds of investigating authority in other countries. This problem tends to arise when the task of investigation falls to prosecuting authorities in one country (as generally happens in the European countries) and to the police or Customs in another (as in the UK and the Islands). Co-operation may then be problematic, especially where the enabling legislation does not allow for differences in responsible agencies or procedures in other countries.

15.4.7 The problem seems to arise most often when other European countries need to co-operate with the UK. Similar problems are liable to arise, however, when they need to co-operate with the Islands.

15.4.8 In my opinion, these problems must be for the UK to resolve in the first instance with other larger jurisdictions. The Islands would then be able to adopt similar solutions. The problems cannot be insuperable. There should be no difficulty in resolving them through discussion leading to Memorandums of Understanding and, if necessary, minor changes in the wording of legislation.

*(d) Routing of requests*

15.4.9 The prosecution, police and regulatory authorities in some of the countries I visited seemed to believe that requests for assistance from the Islands have to be routed through the Home Office in the UK or even the Foreign and Commonwealth Office. This misperception arises at the stage of obtaining evidence as well as at the investigation stage.

15.4.10 In fact there is no such requirement. The right course for overseas authorities is to make contact directly with the relevant Island authorities.

*(e) Assumptions that no assistance will be forthcoming*

15.4.11 Some of the overseas prosecutors and regulators I met, perhaps influenced by responses received in other offshore centres, assumed that there was no point in asking the Islands for assistance in the investigation of crimes or regulatory offences, since no assistance would be forthcoming.

15.4.12 As will be clear from the above discussion, the Island authorities all have a firm policy of full co-operation with other countries in the pursuit of crime. There is every point, therefore, in asking the Island authorities for assistance. I hope that the present Report, and the Island Guides in Parts II to IV, may help to clarify this.

*(f) Facilities for overseas investigators*

15.4.13 A final point, which the authorities in several countries made to me, is that investigation is greatly facilitated if the requesting country's own investigators are able, in appropriate cases, to join the local investigators in making searches and conducting interviews.

15.4.14 In practice, all the Island authorities are willing to arrange for this.

**15.5 Obtaining evidence**

15.5.1 As discussed above, some of the difficulties associated with the investigation stage have arisen also at the stage of obtaining evidence for use in Court. For the most part, however, the Islands' procedures for obtaining evidence for overseas authorities have been less problematic.

15.5.2 Although the areas where assistance can be given have been limited in the ways already described, the authorities have been able to provide assistance to overseas authorities in the vast majority of cases where formal requests have been made. The Island sections set this out more fully.

*(a) Letters of Request procedure*

15.5.3 In all the Islands, the traditional procedure for providing evidence is through formal Letters of Request, known in Jersey and Guernsey as "Commissions Rogatoires".

15.5.4 Under Evidence (Proceedings in other jurisdictions) Orders dating from the early 1980s, the Jersey and Guernsey Courts can comply with Letters of Request from Courts in other jurisdictions where proceedings have begun. They can order the provision of documents or evidence for use in such proceedings. There is no restriction on the type of crime except that political offences are excluded. The Jersey and Guernsey authorities are able and willing to give assistance on purely fiscal cases under this statute.

15.5.5 In the Isle of Man, the Criminal Justice Act 1991 provides for the Attorney General, to whom Letters of Request are addressed, to assist in obtaining evidence in connection with criminal proceedings or investigations that have been instituted in the requesting country. The only restriction is that when the request relates to a fiscal offence where proceedings have not yet been instituted, the Island authorities will not act on the request unless (a) it comes from a Commonwealth country or (b) it is made pursuant to a treaty to which the UK is a party or (c) the Attorney General is satisfied that the conduct concerned would constitute a similar offence if it had occurred on the Island.

15.5.6 The Island authorities may wish to consider whether this restriction continues to be justified.

15.5.7 In all the Islands the more recent legislation on fraud, drug trafficking, terrorist offences, insider dealing and all crimes money laundering can sometimes offer faster procedures for obtaining and providing evidence. The Island authorities are always willing to advise overseas jurisdictions on this.

*(b) Swearing of documents*

15.5.8 Some problems have arisen from time to time on the swearing of documents for use as evidence in the Courts of other jurisdictions. The US Courts in particular require sworn statements of authenticity under penalty of perjury before such documents can be used in evidence.

15.5.9 In my assessment, these problems must be soluble. The Evidence (Proceedings in other jurisdictions) Orders already mentioned allow the Courts in Jersey and Guernsey to order that evidence be given under oath for use in other jurisdictions. The question is what happens on the rare occasions when witnesses are reluctant to sign the relevant affidavits. The authorities have told me that the problem can always be solved in case of need through the Letter of Request procedure. There may also be some scope for accelerating procedures in case of need and for extending to the investigation stage the powers to obtain sworn statements.

*(c) Evidence in fiscal cases*

15.5.10 With regard to fiscal cases, the Double Taxation Agreements (DTAs) with the UK do not permit information exchanged under the Agreements to be used as evidence. As discussed in Chapter 14, there is a case for updating or replacing this and other aspects of the DTAs.

15.5.11 The Tax Offices in all the Islands have no general powers to collect information for the benefit of tax authorities in other jurisdictions. But the Island authorities are prepared to obtain evidence relevant to criminal proceedings in the same way as for other categories of offences. In none of the Islands does there have to be an Island "tax interest" before they are able to give assistance at the investigation, evidence or confiscation stages.

**15.6 Extraditions**

15.6.1 The UK's Extradition Act 1989 applies directly to all three Islands. Extradition proceedings, if needed, take place before a Metropolitan Stipendiary Magistrate in London. The Island Courts do not have power to prevent the removal of a defendant to the UK, although in most cases a judicial authority in the Islands has to endorse the warrant issued by the magistrate in the UK.

15.6.2 The Isle of Man authorities have noted that the Second Protocol to the European Convention on Extradition has not been extended to the Islands. It would appear, therefore, that a person may not be extradited to a Member State of the EU, other than the UK, in respect of a fiscal offence alleged to have been committed in the Member State concerned.

### 15.7 Restraints and confiscations

15.7.1 All the Islands are able and willing to trace, restrain and confiscate assets held by suspects or convicted criminals, whether based on the Islands or overseas, where the predicate offences are concerned with drugs or terrorism. As explained in the Island sections, the Island authorities have already confiscated significant amounts under the drug trafficking legislation.

15.7.2 The new All Crimes Money Laundering legislation in Jersey and Guernsey will extend similar powers to proceeds from crimes of all kinds, subject to the "locally indictable offences" limitation in Guernsey and the "maximum sentence of a year or more" limitation in Jersey discussed in Chapter 14. These powers will extend to the proceeds of tax offences.

15.7.3 In the Isle of Man, the authorities already have similar powers in relation to crimes of all kinds under the Criminal Justice Act 1990.

15.7.4 When the new legislation is in place, including the necessary secondary legislation, all three Islands will be able and willing to restrain and confiscate proceeds of crimes of all kinds, including tax evasion, in response to requests from overseas authorities, within the limitations just mentioned. The Isle of Man is already in this position.

15.7.5 Whenever necessary, civil procedures can be used as well. The Islands' Courts regularly issue Mareva restraint injunctions. They also can and do order financial institutions to disclose information in civil proceedings for the purposes of tracing the proceeds of financial crime. As discussed in Chapter 14, there may be scope for extending the use of civil law remedies.

### 15.8 Prosecutions and convictions

15.8.1 Where the Islands themselves are the lead-jurisdictions, they all have a policy to prosecute financial crime, like other crime, whenever there is sufficient evidence and a reasonable prospect of conviction.

15.8.2 The Island authorities have not in practice needed over the years to bring more than a small number of prosecutions relevant to the international finance centres. In the vast majority of cases, criminal offences involving the finance centres have been committed elsewhere. The Islands' main role has therefore been to assist the investigating and prosecuting authorities of other jurisdictions, as described above, rather than prosecute the cases themselves.

15.8.3 Where the Island authorities have brought prosecutions, conviction rates have generally been high. Grants of immunity from prosecution are almost unknown.

15.8.4 The case which has attracted most attention in recent years is the Bank Cantrade case in Jersey (1998). The Jersey Island section includes a brief description of the case. Chapter 7 discusses some of the regulatory implications.

15.8.5 The victims in the case, and their representatives, have criticised certain aspects of the authorities' handling of the case. The authorities did succeed, however, in obtaining two guilty verdicts and a partial guilty plea in a very complicated case.

15.8.6 As regards wider implications for criminal justice, the authorities are proposing, as discussed in Chapter 14, that the statutory time-bar on bringing prosecutions should be repealed. Another lesson they have drawn is that specialist Counsel and forensic accountants should be brought in from England at the earliest stage in cases of such size and complexity.

### 15.9 Penalties

15.9.1 The Royal Court in Jersey has a policy to impose more severe sentences than in England. Guernsey has its own sentencing policy. The Isle of Man Courts follow English sentencing practice.

# 16 FINANCIAL CRIME AND MONEY LAUNDERING: RESOURCES AND STRUCTURES

### 16.1 Policy on resources

16.1.1 In all the Islands the authorities are firmly committed to providing the resources of judiciary, prosecution, law enforcement and intelligence necessary to police their international finance centres effectively. The importance of this commitment needs no elaboration.

### 16.2 Judiciary and prosecution resources

16.2.1 As explained in Chapter 5 and the Island sections, each Island has two senior *Judges* and supporting Judges. If necessary, Judges can be brought in from outside as well. The Appeal processes are well established.

16.2.2 My impression is that the Island Judiciaries have been and remain well able to cope with the considerable workloads associated with the international finance centres.

16.2.3 Each of the Islands likewise has two senior *law officers*, known as the Attorney General and Solicitor General in Jersey, HM Procureur and HM Comptroller in Guernsey, and the Attorney General and Government Advocate in the Isle of Man.

16.2.4 In each Island, the law officers combine the important roles of public prosecutors, legal advisers to the Island Parliaments and supervisors (Guernsey) or advisers (Jersey and the Isle of Man) on the drafting of legislation. They have important roles, too, in relation to the provision of assistance to investigating authorities in other jurisdictions.

16.2.5 The law officers are assisted by 11 legal advisers and assistants in Jersey, 7 in Guernsey and 5 in the Isle of Man. These figure, however, mask different mixes of skills and experience and are not necessarily comparable. Separate teams of 7, 4 and 2 specialist lawyers, respectively, are responsible for drafting of legislation. The Islands buy in expert resources from outside when required.

16.2.6 As discussed in Chapter 5, the law officers in all the Islands have a firm policy to prosecute crime wherever there is sufficient evidence and a reasonable prospect of conviction. This is clearly a key requirement in any international finance centre. So far as I am aware, the policy has not been constrained by shortage of resources.

16.2.7 The law officers do, however, bear heavy burdens. It is therefore crucial that they should have the resources they need. The Guernsey team is also directly responsible for the preparation of legislation and approving the registration of companies. In my opinion, the Guernsey authorities may need to take on two or three extra qualified staff. Jersey and the Isle of Man may have similar needs.

### 16.3 Police and Customs: resources

16.3.1 As indicated in the accompanying Box, the Islands employ relatively high proportions of their total populations in police and Customs work:

- Jersey employs one person in 220 in such work.

- Guernsey employs one person in 230 at present, including significantly more Customs officers than the other Islands, but plans to employ extra police and civilian support which will raise the proportion to one person in 208.

- The Isle of Man employs one person in 244 in such work but a small increase in establishment is planned.

  The proportion in the UK is similar to that in the Isle of Man.

16.3.2 Of particular concern for the international finance centres is the allocation of resources to fraud and commercial work, financial intelligence and investigations. As in the UK, but in contrast with most European jurisdictions, the Islands' Police and Customs authorities rather than the prosecuting authorities are responsible for criminal investigations.

16.3.3 The tasks undertaken by these sections include:

Investigation of financial crime
Obtaining evidence
Dealing with suspicious transaction reports
Responding to requests for assistance from other jurisdictions
Relations with the finance sector, companies and professionals.

16.3.4 As indicated in the accompanying Box, Jersey now employs 11 people in these areas, including 2 Customs officers. Guernsey employs 8, again including 2 Customs officers. The Isle of Man employs 6.5, all police officers (there is one vacancy at present).

16.3.5 The drug trafficking intelligence bureau in Jersey, with 14 staff, the FSC in Guernsey and the small enforcement unit in the Isle of Man's FSC, with 3 staff, all do some work which the police might undertake in the other Islands.

16.3.6 In considering whether Police and Customs have sufficient resources in each of the Islands, three questions are especially relevant:

- First, are they able to deal promptly and effectively with suspicion reports, including briefing and feedback to the provider institutions?

- Second, are they able to respond promptly and effectively to requests for information, investigations or evidence from other jurisdictions?

- Third, are they able to devote the resources needed to investigating local criminals and putting them out of business? 16.3.7 Taking these questions in turn, my impression is that the Jersey and Guernsey authorities probably *do* have the resources needed at the moment to process and investigate *suspicious transaction reports*, and to provide feedback.

16.3.8 The Isle of Man authorities, on the other hand, receive more reports than the other two Islands, partly because of their relatively big life insurance sector, while having fewer staff to deal with them. They have therefore to operate a sifting process which is clearly less than ideal.

16.3.9 All the Islands have recognised the need for more resources to deal with the increase in reports which is expected when all crimes money laundering takes effect.

16.3.10 All the Islands, again, have given priority to *meeting requests for assistance* from overseas jurisdictions. Response times have generally been impressive. Requests for assistance have undoubtedly, however, put pressure on the resources of the law officers and the police. Such pressures can only increase, moreover, when the new and forthcoming legislation takes effect.

16.3.11 With regard to *investigating local criminals* who pose a threat to the finance centres and putting them out of business, the Isle of Man authorities acknowledge that more could be done with greater resources. The authorities in the other two Islands have not identified this as a problem to the same extent.

16.3.12 The conclusions I would draw are:

- All the Islands will need extra resources to deal with the expected increase in numbers of suspicious transaction

reports and confiscation orders after the new all crimes legislation and suspicion reporting take effect. Jersey and Guernsey have provisionally estimated a requirement for 2 extra staff.

- The Isle of Man seems to have a special need for extra staff in this area. The requirements discussed above suggest that perhaps 4 extra staff are needed, in addition to filling the present vacancy and an extra 2 staff for the all crimes suspicion reporting. The Head of the Fraud Squad should preferably have no other responsibilities.

- The Jersey authorities are likely to need some more staff in this area as they introduce their proposed new legislation and policies.

- The Guernsey authorities, too, will probably need to allocate some of the increase in police numbers now proposed to these important tasks.

16.3.13 The policing and regulation of the international finance centres place considerable burdens on the Islands. The FSCs, the Fraud and Financial Investigation Units and the Prosecuting authorities between them employ between 55 and 65 people in each of the Islands. The Fraud Squad in the Isle of Man spends more than half its time responding to requests for assistance of all kinds from other countries. In Jersey and Guernsey, too, the commitment is heavy.

16.3.14 As noted at the beginning of the Chapter, however, the Island authorities accept that they have an absolute obligation to police and regulate their international finance centres to the highest standards, to co-operate with overseas authorities and to make the necessary resources available.

### 16.4 Police and Customs: structures and financing

16.4.1 Both Jersey and Guernsey have small *Financial Investigation Units (FIUs)*, jointly staffed by 2 police and 2 Customs officers, which deal with suspicious transaction reports and requests for assistance from overseas jurisdictions. As explained above, the staff in both units will be increased by 2 to deal with the expected increase in suspicious transaction reports when the all crimes money laundering laws take effect.

16.4.2 Jersey also has a substantial *Drug trafficking intelligence* bureau employing 14 staff.

16.4.3 The Isle of Man does not have a joint Financial Investigation Unit. Customs operate separately from, though in close consultation with, the police. The police's *Fraud Squad* undertakes most of the tasks undertaken elsewhere by the Joint FIUs. It acts as the receiving house for suspicious transaction reports and requests for intelligence from overseas.

16.4.4 In my opinion, there are strengths as well as weaknesses in all the Islands' structures. Jersey and Guernsey seem to me right to have joint financial intelligence and investigation units bringing together police and Customs. The Isle of Man seems to me right to have a single unit dealing with fraud as well as financial intelligence and investigation.

16.4.5 The Island authorities have been considering further reforms of structures. In my opinion, there is a strong case to be considered for self-standing "Financial Crime Unit" structures along the following lines:

- *Single, self-standing units*. The activities of the present Fraud Units and Joint Financial Investigation and Intelligence Units (and possibly the Drug Trafficking Intelligence Bureau in Jersey) would be brought together into single, self-standing units, which might be known as *Financial Crime Units*.

- *Responsibilities*. The Units would be responsible for policing the Islands' finance centres and supporting the Attorney Generals in their roles as public prosecutors for the finance centres.

- *Tasks*. Specific tasks would include intelligence, handling of suspicion reports, maintenance of a comprehensive database, investigation of financial crimes including money laundering and tax evasion, obtaining of evidence, seizures, restraints and confiscations, relations with the finance, company and professional sectors, and assistance to other jurisdictions.

- *Multidisciplinary units*. The new units would preferably (like the Northern Ireland Terrorist Finance Unit) be multidisciplinary units, including Customs and direct tax staff as well as police officers, with policy, accountancy and information technology support. Professional assistance would continue to be bought in from outside as

required.

- *Full-time Heads*. The Directors of the units would be full-time. They would not have other responsibilities.

- *Reporting lines*. The Units would be separate from the Police, Customs and Attorney General's Offices. But the Director could report to the Attorney General, with dotted reporting lines to the Chief Constable and the Treasury or equivalent Committee.

- *Links with other agencies*. The Units would work in close co-operation with the Attorney General's office, the Police, Customs, the Tax departments and the financial regulators.

- *Dedicated financing*. The Units would be financed separately from the Police and Customs. The Attorney Generals would be responsible for ensuring (or confirming) that budgets and staffing were adequate to provide effective policing of the finance centres and support for the prosecutors. The Chief Constables or the Police Committees would no longer have the difficult task of dividing resources between the policing of the finance centres and general policing.

- *Staff and training*. Staff would be encouraged to make careers in this important but specialist area of work.

  They would no longer be required to move back and forth between this and other policing work. Special priority would be given to training programmes, including UK programmes.

16.4.6 Dedicated financing is not the least important element in this prospectus. In my opinion, Chief Constables and Police Committees are not well placed to determine the allocation of resources between fraud, financial crime and assistance to other jurisdictions, on the one hand, and general policing on the other. The Police are always under pressure, quite understandably, to give more resources to physical crime and neighbourhood policing. Switching resources from this area to financial crime will always be difficult. The present allocation mechanisms are very likely, therefore, to lead to under-resourcing of finance centre policing.

### 16.5 Comparison with the UK and other countries

16.5.1 It must be acknowledged that an integrated structure on the lines suggested would be very different from present UK structures.

16.5.2 In the UK, there is a National Crime Intelligence Service, NCIS, jointly staffed by the Police and Customs with some involvement of other Departments including the Inland Revenue. There are separate Customs and Police units for investigation of drug trafficking and organised crime. There is a Serious Fraud Office which investigates and prosecutes a limited number of serious or complex cases. And there are more than 50 fraud squads, independent of each other, which come under the Chief Constables and Police Authorities of the individual Police Authority areas.

16.5.3 The Police Authorities and Chief Constables are responsible for determining what priority, resources and budgets should be given to the pursuit of financial crime by fraud squads as against other forms of crime. And police staff mostly do short periods of duty in these specialist areas.

16.5.4 There are two main comments that should be made on the differences between present UK models and those suggested above for consideration by the Islands.

16.5.5 First, the Islands have options, because they are small, that the UK and other large jurisdictions do not have. One such option is that they can if they wish bring closely related functions together in one Unit. Such functions might ideally be brought together in all countries. This may not, however, be a realistic option in the major countries because the resulting units would be impossibly large.

16.5.6 Second, the many professionals I consulted seemed mostly to feel that the UK's own structures for dealing with fraud and financial crime, and the systems for resource allocation, are anyway far from ideal. There seemed in particular to be a broad consensus on the case for a National Fraud Squad including permanent specialist staff of various disciplines and financed independently of the local police forces.

**BOX 16.1-Law Enforcement Resources and Structures**

*number of full-time-equivalent staff in post, including civilians, March 1998*

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| Police | | | |
| Uniformed | 340 | 149* | 213*** |
| Other | | 36* | 33** |
| Customs and Immigration | 53 | 67 | 48 |
| TOTAL | 393 | 252 | 294 |
| Total as % of population | 0.46% | 0.43% | 0.41% |
| Of which: | | | |
| Fraud / Commercial units (police) | 7 | 3.5 | 6.5 |
| Financial investigations unit (part of police fraud unit in IoM; joint unit in J & G) | 4** | 4.5** | |
| Drug trafficking intelligence bureau (J only, joint unit) | 14 | — | — |

NOTES
* Guernsey is committed to adding 5 civilians immediately and 28 police officers over the next three years.
** Jersey and Guernsey propose to allocate 2 extra staff when the all crimes money laundering provisions take effect.
*** The Isle of Man police establishment has recently been raised to 218 police officers plus 36.5 civilian support staff.

# 17 INTERNATIONAL STANDARDS

### 17.1 Introduction

17.1.1 The Island authorities all have a clear objective that their finance centres should be the best of offshore centres, not only in terms of quantity and quality of business but also in terms of international standards of regulation, policing and co-operation. Earlier Chapters have been concerned, directly or indirectly, with how the Islands can achieve and sustain such standards.

17.1.2 The Island authorities have been concerned at the same time:

- to sustain business while achieving ever higher standards of regulation;
- to win international recognition for high standards; and
- to promote high standards in offshore centres generally.

### 17.2 Sustaining business

17.2.1 In my discussions with the authorities and practitioners in the Islands, the need to sustain business was a constant refrain. This is inevitably a continuing concern for any centre that relies as heavily as the Islands do on their finance industries. There are sometimes fears that higher standards of regulation, policing and co-operation will lead to loss of business, not just disreputable business whose loss will be welcome but also reputable business from clients who see the privacy of their affairs as threatened.

17.2.2 Understandable as such concerns are, the authorities in any finance centre have clearly to accept that high standards of regulation will drive away some categories of business just as it will encourage others. They have also to accept that, when regulation is improved, some good business may be lost as well as bad.

17.2.3 The Island authorities fully accept these points. In all cases, they see high standards of regulation as an absolute obligation. They all accept that fears about loss of business cannot excuse poor regulation or policing of their finance centres.

17.2.4 In my opinion, the commitment to high standards is very much in the Islands' own interests as well as being an absolute obligation. In the longer-term, good regulation is likely to attract more business than it drives away. The business it attracts will, moreover, be likely to be good business. The business it deters will in many cases be business that the Islands would rather not have.

17.2.5 As the Island authorities have found, the UK and European financial institutions who are the largest source of Island customers will on the whole be strong supporters of good regulation provided that it is not over-regulation.

17.2.6 Anxieties about loss of business will be further allayed if improvements in regulation can be implemented at about the same time throughout the offshore. As discussed below, therefore, the Islands have been keen to promote co-operation between the offshore centres and a level playing field.

### 17.3 International recognition: accreditation

17.3.1 The Island authorities have understandably been concerned that Governments, regulators, law enforcers, practitioners and customers in the rest of the world should recognise the standards they achieve.

17.3.2 International recognition of high standards is likely to enhance the benefits to those who achieve them. Without recognition, the incentives in all centres to improve standards may be diminished. The Island authorities have therefore been keen, rightly in my view, to promote such recognition.

17.3.3 There are two main forms that recognition can take:

- international accreditation of regulatory and counter-crime standards by the main international institutions and associations, and

- favourable treatment by the large countries of individual small jurisdictions that meet certain regulatory and counter-crime standards.

17.3.4 On *accreditation*, some progress has been made and the Islands have been prominent in pressing for it:

*(a) FATF*

The international *Financial Action Task Force (FATF)*, set up by the G7 in 1989 to combat money laundering, does not admit small jurisdictions to membership. It has, however, encouraged the Offshore Group of Banking Supervisors, OGBS (in which, as discussed below, the Islands play leading roles), to extend its activities to include the combating of money laundering. It has also set up a Caribbean Task Force and encouraged the development of a similar regional Task Force in Asia.

The FATF has also agreed a procedure for dealing with non-FATF members which involves an element of accreditation. Members of the OGBS and other Task Forces have been invited:

- to subscribe to the Forty Recommendations of the FATF by means of formal Ministerial letters of commitment, and

- to submit themselves to inspection by mutual evaluation groups, including experts from FATF countries.

Mutual evaluation inspections of the Crown Dependencies have been planned for early next year. It is hoped that experts from the USA, France and Holland will be willing to take part.

The FATF have clearly taken an important step towards international accreditation of systems for countering money laundering. There are some in the Islands who believe that all jurisdictions involved in the fight against money laundering should be members in their own right. I have some sympathy with this view. An intermediate solution might be for the FATF to convene once a year a wider forum of FATF and FATF-associated jurisdictions.

*(b) Basle Committee on Banking Supervision*

The Basle Committee on Banking Supervision, like the FATF, restricts its membership to the large countries. The Committee has, however, recently agreed that experts from member countries may take part in peer group reviews of whether OGBS members' banking supervision meets the Basle "core principles" for effective banking supervision, though they have to limit themselves to factual matters. The OGBS Group itself then makes an evaluation, based on the factual analysis.

This, too, is clearly a promising step in the direction of international accreditation, though the process has been slow in getting off the ground. The central banks and supervisors of the major countries have been hesitant to take part directly in the reviews for reasons of moral hazard. The search has therefore switched to retired supervisors.

*(c) International Organisation of Securities Commissions, IOSCO*

In contrast with the FATF and the Basle Committee, the International Organisation of Securities Commissions, IOSCO, accepts smaller jurisdictions as members. All the Islands are members and play a full part in IOSCO's work.

IOSCO has been active in seeking to promote international standards of investment and securities regulation and co-operation between supervisors. IOSCO has developed "self-evaluation" exercises for members, including special exercises in

areas such as investment business regulation and information on beneficial ownership of companies.

*(d) International Association of Insurance Supervisors, IAIS*

The International Association of Insurance Supervisors, IAIS, likewise accepts smaller jurisdictions as members. All countries are eligible to join. All the Islands are members. They were, indeed, founder members.

Established in 1993, the IAIS is the youngest of the triumvirate of international financial supervisory bodies. The secretariat is situated in the Bank for International Settlements in Basle and uses the same facilities as the Basle Committee on Banking Supervision.

The IAIS has sought to bring all members to at least a minimum standard of legislation, regulation and supervision. Standards have been defined accordingly for principles of insurance and work is in progress on fraud and money laundering issues. It distributes annually a self-assessment questionnaire on insurance supervision and asks each member to complete and return it. Where the answers suggests that minimum standards are not being met, the member concerned is required to submit a statement of plans to achieve compliance.

17.3.5 In addition to these bodies, the Islands are members of more specialist international groups including the Egmont Group of professionals from national crime intelligence and investigation units, the International Group of Insurance Fraud Agencies, and the Enlarged Contact Group on the Supervision of Collective Investment Funds.

17.3.6 The Islands have also been instrumental in establishing and developing an Offshore Group of Insurance Supervisors, which undertakes mutual evaluations on OBGS lines, as well as the OGBS (see further below).

17.3.7 Promising as all these activities are, the systems for international co-operation have not yet developed to the point where there is a clear distinction in all the main areas of regulation and counter-crime systems between accredited and non-accredited countries, based on rigorous criteria consistently applied. For onshore as well as offshore centres, the international organisations have been anxious, perhaps over-anxious, to avoid the moral and practical hazards of endorsing (or appearing to endorse) standards of regulation. In some parts of the world, moreover, countries have not been eager to submit their systems for evaluation.

17.3.8 In my opinion the Islands have been right to press for progress on international accreditation and should continue to do so.

17.3.9 In the case of the FATF and the Basle Committee, the limitations on membership complicate the task of spreading international standards and accreditation to all jurisdictions. The development, alongside the existing arrangements, of *wider forums of countries that wish to achieve similar standards* might be helpful in this connection. The United Nations has held some co-ordinating meetings on money laundering.

17.3.10 A further lacuna is that there is no comparable international body or forum that sets or monitors standards in the critical areas of Trusts and related company vehicles. Part of the reason may be that the authorities in the major countries have not as yet perceived any particular need to oversee the development of Trust instruments and the related law or to regulate trustees. The UK would be well placed to promote establishment of an international forum on Trusts.

**17.4 International recognition: favourable treatment**

17.4.1 With regard to favourable treatment of high-standard jurisdictions by the larger countries individually, there is scope for the larger countries to grant such jurisdictions market access and other privileges, in return for high standards of regulation and co-operation. Some examples of this are:

- The UK's grant of "designated territory" status under section 87 of the Financial Services Act 1986 to jurisdictions wishing to promote authorised *collective investment schemes* to the general public in the UK;

- The UK's similar grant of designation under section 130 of the Financial Services Act 1986 for *life and pensions insurers*.

17.4.2 All three Islands have designated territory status in each area. This enables them to market investment, insurance and pension products to UK residents which non-designated providers outside the EU would not be permitted to do.

17.4.3 The Islands also have agreements with a number of other countries, inside the EU and elsewhere, which facilitate access for their fund products into those jurisdictions.

17.4.4 Tax authorities, too, in the larger jurisdictions have some scope to promote high standards internationally by designating co-operative jurisdictions and facilitating taxpayers' business with them. The US authorities explicitly differentiate between more and less co-operative jurisdictions. They apply more stringent enforcement procedures, and tax penalties, to those of their taxpayers who have dealings with low-standard, unco-operative jurisdictions.

17.4.5 These instruments for promoting and recognising high standards seem to me potentially powerful. The scope for the larger countries to develop them further seems considerable.

### 17.5 Offshore standards generally

17.5.1 The Islands' reputations are liable to suffer from jaundiced perceptions of offshore centres generally, even when the Islands themselves are beyond reproach. This "suffering by association" may exacerbate the shortfalls of international recognition for standards achieved discussed above.

17.5.2 The problem is probably not susceptible of a complete solution. The policies for accreditation and positive discrimination discussed above, if they can be developed, should help to alleviate the problem by reducing public perceptions that offshore jurisdictions are all alike. But they will not solve it totally.

17.5.3 The other means to alleviate the problem, clearly, is through the *promotion of high standards in the offshore generally*. In this, too, the Islands have taken a leading role.

17.5.4 The Jersey authorities in particular have been instrumental in developing the role of the Offshore Group of Banking Supervisors (OGBS), including the Group's involvement in the FATF processes for combating money laundering. Jersey's Chief Adviser has been Chairman of the Group since 1981. The OGBS was the first to be established of the regional groups linked to the Basle Committee. It has sought to establish entry standards. The OGBS expects all its members to subscribe to the Forty Recommendations. All except Lebanon have responded positively. Lebanon is now therefore an observer rather than a member of the Group.

17.5.5 The Guernsey authorities have been instrumental in developing a parallel Offshore Group of Insurance Supervisors, OGIS. The Insurance Director in Guernsey's FSC has Chaired the Group since its establishment in 1993. The Group's purpose is to raise supervisory standards throughout offshore insurance. Members have to meet the five criteria of adequate legislation, proof of enforcement, adequate resources, ability to exchange information with overseas supervisors, and commitment to meet the FATF recommendations. The Group encourages jurisdictions with poor supervisory reputations to join as observers provided that they accept a commitment to strive to achieve membership.

17.5.6 These Groups have a considerable potential to promote high standards and improve the reputation of offshore centres generally through application of peer-group pressure. In this they have been partially successful, but only partially.

17.5.7 The present Groups have had to contend with a range of problems similar to those of other international groups. These include:

- *Membership*. There is an issue whether membership should be universal (so as to maximise the benefits that flow from having all supervisors meet regularly with counterparts) or selective (so as to differentiate between those who have and have not achieved compliance with Group standards).

  The OGBS have opted for a selective approach. Their membership of 19 (see Box 17.1) does not include several offshore centres. In recent years, the Group has rejected applications for membership from 5 offshore centres. On the other hand, the Group has allowed a similar number of existing members to remain even though (in the opinion of some experts) they appear to fall short of the standards endorsed by the Group.

  The alternative approach is to combine selectivity with comprehensive coverage through a system of members (who

are achieving compliance) and observers (who are committed to trying to achieve compliance), as the OGIS has sought to do and the OGBS itself has done in relation to Lebanon.

- *Speed of progress*. Such Groups often find it difficult to make progress. FATF-style mutual evaluations, for example, have been slow in getting off the ground.

  In the OGBS, appointment of a paid working Chairman devoting much of his time to the Group's affairs might help to accelerate progress.

- *Subject coverage*. Although the OGBS has taken on a role in relation to money laundering and FATF-style evaluations as well as banking supervision, it does not cover all aspects of the regulation and policing of offshore centres.

  There may be a case for developing a new structure comprising an *Offshore Steering Group (OSG)* at senior level with sub-committees as necessary for individual areas of regulation or counter-crime.

- *Interlocuteurs valables*. Especially in the field of financial crime and money laundering, but more widely as well, it would seem helpful to develop more regular contacts between onshore and offshore.

  When the large countries meet to discuss issues such as drug trafficking, money laundering, international aspects of supervision and international co-operation, for example, they could usefully make a habit of inviting an OGBS representative to represent the offshore.

  For onshore and offshore alike, moreover, there could be advantage in periodic discussions between representatives of the OSG and a suitable body from the onshore jurisdictions. The latter body might bring together representatives of major countries associated with offshore centres (such as the UK), other interested countries or country groupings (such as the US, the OECD and the EU) and international financial bodies (such as the IMF). A forum on these lines could help to build a more constructive relationship between the onshore and offshore worlds.

  The UK, as a major country associated with many offshore jurisdictions, might be well-placed to convene such a forum.

### 17.6 Fallback option

17.6.1 If the various approaches discussed above do not bear fruit, there could be a case for the UK, the Islands and the British Overseas Territories to set up a small independent *Financial Centres Audit Office (FCAO)*, with a Board or Steering Committee drawn from the Islands, the British Overseas Territories and the UK.

17.6.2 An Office on these lines would have no executive powers. In close co-operation with the Island authorities, however, it might:

- maintain *professional guides* for each Island's legal, regulatory and counter-crime frameworks, systems and practices, possibly along the lines of the Island sections of the present Report, where the Islands themselves do not do so;

- *audit* the Islands' regulatory and counter-crime systems and practices on a regular basis, through a rolling programme of periodic reviews of particular areas (such as banking regulation, company registrations, Trust service providers and systems to counter money laundering); and

- *review* with the Island authorities and report on *particular issues* of importance and particular problems as they arise.

17.6.3 In the absence of effective international arrangements, the existence of such a body might help the offshore centres associated with the UK to achieve high standards, a level playing field and an enhanced reputation compared with other offshore centres.

17.6.4 In my opinion, the better course would be to develop international co-operation, accreditation and recognition along

the lines discussed earlier in this Chapter. An FCAO should be considered only if this fails.

**BOX 17.1-Memberships of Offshore Groups, October 1998**

**1 Offshore Group of Banking Supervisors**

| *Members* | *Observers* |
|---|---|
| Aruba | Lebanon |
| Bahamas | |
| Bahrain | |
| Barbados | |
| Bermuda | |
| Cayman | |
| Cyprus | |
| Gibraltar | |
| Guernsey | |
| Hong Kong | |
| Isle of Man | |
| Jersey Chair | |
| Malta | |
| Mauritius | |
| Netherlands Antilles | |
| Panama | |
| Singapore | |
| Vanuatu | |

**2 Offshore Group of Insurance Supervisors**

| *Members* | *Observers* |
|---|---|
| Bahamas | Anguilla |
| Cayman | Aruba |
| Gibraltar | Belize |
| Guernsey *Chair* | Samoa |
| Isle of Man | |
| Jersey | |
| Labuan | |
| Netherlands Antilles | |
| Turks and Caicos | |

# 18 CONCLUSION

**18.1 General assessment**

18.1.1 The main conclusions from the Report appear in the Summary and Main Conclusions at the beginning.

18.1.2 In my assessment, as discussed in Chapter 2, the development of the Islands' international finance centres, especially over the past 20 years, has been a considerable success story. They have infrastructures of legislation, judiciary, prosecution, regulation and law enforcement, mostly based on UK models, which for the most part are extremely good for such relatively small jurisdictions. In many areas they have co-operated well, sometimes remarkably so, with the authorities of other countries in the pursuit of crime and regulatory breaches.

18.1.3 The Island authorities have identified the need for early progress in certain areas. In all cases, they have identified the importance of

- extending the regulatory boundary to encompass Trust and Company service providers,
- successful implementation of the All Crimes Money Laundering regimes and related legislation so as to enable the fullest co-operation with overseas authorities in the pursuit of crime, and
- adequate resourcing of the regulation and policing of their finance centres.

18.1.4 They would all do well, in my opinion, to consider the case for a financial services ombudsman and the points on Trust law discussed in Chapter 12.

18.1.5 In other areas, the strengths, needs and priorities vary somewhat from Island to Island:

- In *Jersey*, the banking, fund management and Trust sectors have been tremendously successful. Certain areas of financial regulation need to be developed and deepened. Consideration should be given to customer protection schemes. Companies operating but not incorporated in the Island need to be registered. But the authorities' most urgent requirement, in my opinion, is to reach a position as soon as possible where they can and do co-operate fully with other countries in the combating of crime of all kinds, including tax evasion and lesser frauds, at the investigation stage. This will require early passage of the Proceeds of Crime, PACE and International Co-operation Laws as well as the changes of policy stance already made.
- In *Guernsey*, the captive insurance sector has been a particular success alongside banking, fund management and Trusts. There are plans to introduce a Stock Exchange. As in Jersey, companies operating but not incorporated in the Island need to be registered. Modern insolvency legislation is needed. Certain aspects of financial regulation need to be developed. Consideration should be given to customer protection schemes. The Law Officers have identified a need for more staff. The most urgent requirements, which the authorities are already tackling, are the proposed legislation to deal with the problem of "nominee" Directors and completion (as in Jersey) of the Proceeds of Crime, PACE and international co-operation legislation.
- In the *Isle of Man*, the insurance sector has made good progress alongside healthy banking and fund management sectors. Regulatory enforcement has been a particular success. The Island has depositor, investor and policyholder protection schemes. As in the other Islands, there are certain aspects of financial regulation where improvement and resources are needed. The police need more resources to combat financial crime and money laundering. The Insolvency legislation needs to be updated. But the urgent requirement, which the authorities are positively addressing, is to review and improve regulation of the Island's large company sector and its considerable population of company and Trust service providers.

### 18.2 Responses to concerns expressed

18.2.1 The Island authorities will wish also to consider carefully and, where appropriate, address the concerns, summarised in Chapter 3, which professionals, customers and others associated with the Islands raised with me. Taking these in turn:

- The suggestions in Chapter 5, where applicable, should do much to alleviate residual concerns about conflicts of interest.

- The proposal in Chapter 6 for a Financial Services Ombudsman should do something to alleviate the perceived absence of any realistic means of redress, short of extended Court processes, for customers in dispute with institutions or professionals in the Islands.

- The Islands' proposals for regulation of Trust and Company service providers, provided that they are developed, implemented and resourced in the ways discussed in the Report alongside the necessary improvements in the regimes for companies and Trusts, should squarely address the concerns expressed by some of my correspondents and interlocutors about

  (a) firms and individuals with questionable track records continuing in business,

  (b) facilitation by such people of tax evasion and other forms of crime and abuse,

  (c) the scope for abuses by trustees,

  (d) the absence of any information about many of the companies operating in the Islands or using the Islands' names, and

  (e) the activities of "nominee" Directors and the consequent damage to the reputations of all the Islands.

- The firm commitment of the Island authorities to co-operate fully with other countries in the pursuit of crime of all kinds, including tax evasion, together with passage of the outstanding enabling legislation, should go a considerable way to allay concerns that the Islands are depriving other countries of tax revenues. The issue of harmful tax competition within the law is beyond the scope of the Report.

- The same commitments by the Island authorities, and passage of the same enabling legislation, together with the proposed resourcing and structural improvements, should enable all the Islands to co-operate (or continue to co-operate) in an exemplary way with overseas authorities in the pursuit of crime of all kinds and regulatory breaches.

### 18.3 Resources

18.3.1 The Report has identified needs for extra skilled staff in several areas to police and regulate the Islands' international finance centres. The Box 18.1 table, based on the discussion in earlier Chapters, indicates a suggested requirement for a total increase of around 20 staff *gross* in each Island.

18.3.2 It may be possible to meet some of the requirement by redeployments from elsewhere. There might, for example, be scope for some redeployment of staff from the drugs intelligence unit in Jersey, from the Customs service and the increase already proposed in total police numbers in Guernsey, and from other areas of police work and merging of the regulatory agencies in the Isle of Man.

### 18.4 Implementation

18.4.1 Box 18.2 lists, for convenience, the main policy, legislation and other changes discussed in the Report. Some are the Islands' own proposals and already form part of the forward programmes. Others are suggestions made in the Report which I hope the Island authorities will carefully consider. In nearly all cases, the final decisions will, of course, be for the Islands' Parliaments.

18.4.2 The successive blocks in the list indicate my thoughts as to a broad order in which the various changes might be considered and tackled. I emphasise that they are no more than that.

18.4.3 I hope, however, that by the spring of 2000 the Island authorities will either have implemented or be well on the way to implementing all the proposals discussed, except where they are contingent on prior action by the UK, or will have decided what alternative courses to pursue.

**BOX 18.1-Possible Requirements for Extra Staff Indicated by the Report**

*Increase in full-time eqivalents, gross*

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| Support for Law Officers | 3 | 3 | 1 |
| Police and other staff for Fraud and Financial Intelligence Units | 4 | 3 | 7 |
| Registration of Companies not locally incorporated, returns of beneficial ownership, enforcement, etc | 3 | 3 | 3 |
| Regulation of banks, investment business & Stock Exchange | 3 | 3 | 4 |
| Regulation of insurance | | 1 | 1 |
| Regulation of Trust and Company service providers | 5 | 4 | 5.5 |
| Enforcement | 3 | 1 | |
| Customer protection and support to Ombudsman | 1 | 1 | 0.5 |
| Support staff | | | -1 |
| TOTAL | 22 | 19 | 21 |

**BOX 18.2-Principal Measures Discussed in the Report**

The accompanying list includes items already planned by the Island authorities as well as suggestions made in the Report. In almost all cases, final decisions will be for the Island Parliaments.
* Would require no legislation or only minor legislation.
** Would require major primary legislation or treaty.

| *Measures* | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| All Crimes Money Laundering (decided) | ** | ** | |
| Removal of prosecution time-bar (decided) | * | | |
| PACE law or equivalent (decided) | ** | ** | |

| | | | |
|---|---|---|---|
| International Co-operation law (decided) | ** | ** | |
| Regulation of Director services (decided) (Chapter 11) | | ** | |
| Recruitment of extra staff for law officers, police & FSCs (Box 18.1) | * | * | * |
| Possible structural changes in Fraud and Financial Investigation (Chapter 16) | * | * | * |
| FSC and Regulatory changes, inc Board and structural changes (Chapter 6) | * | * | * |
| Depth of regulation proposals (Chapter 6) | * | * | * |
| Licensing & Regulation of Trust and Company Service providers etc (Chapters 12 & 13) | ** | ** | ** |
| Company regulation changes, inc beneficial ownership and non-resident companies (IoM), registration of companies incorporated elsewhere (J,G), LLPs disclosure regime (J) (Chapters 10 & 11) | ** | ** | ** |
| Insolvency legislation (G, IoM) and rescue provisions (Chapter 10) | * | ** | ** |
| Possible changes in Trusts legislation (Chapter 12) | ** | ** | ** |
| Customer Protection schemes (Chapter 6) | ** | ** | |
| Financial Services Ombudsman (Chapter 6) | ** | ** | ** |
| Insurance regulation changes (Chapter 9) | * | * | * |
| Investment business regulation changes (Chapter 8) | * | * | * |
| Possible new Double Taxation or Exchange of Information Agreements (Chapter 14) | ** | ** | ** |

# APPENDIX A
# REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES TERMS OF REFERENCE

**Objective**

To review with the Island authorities their laws and systems and practices for:

(i) regulating banking, insurance and financial services business and collaborating with overseas regulators;

(ii) deterring, investigating and punishing financial crime, including money laundering and fiscal offences, particularly cases with an international dimension;

(iii) registering companies;

with a view to assessing the contribution which they make to the economic and social well-being of the Islands themselves and of the United Kingdom.

**Areas to be covered**

The review will cover the following main areas:

(i) Financial Regulation and International Regulatory Co-operation

Description and assessment of the current legal and institutional arrangements for licensing, supervising and regulating the full range of financial business, including banks, investment banks, other credit institutions, insurance companies, investment service companies, bureaux de change, international business companies and company registration agents and accountants and lawyers carrying on financial business (eg providing custody services or investment advice);

Examination of practical implementation of these activities and the resources devoted to them, in relation to the number and size of firms regulated and the nature of their business;

Arrangements for the regulatory authorities to share their own confidential information with overseas regulatory authorities, and vice versa;

Arrangements for the authorities to obtain other confidential information to assist overseas regulatory authorities with their investigations and vice versa.

(ii) Financial Crime

(a) Money Laundering

Each Island's money laundering legislation;

The number of suspicious transactions reports received in each Island each year and how these are dealt with;

Arrangements for collaboration between the Island Authorities and overseas authorities including the sharing of suspicious transaction reports;

(b) Criminal Investigations

Collaboration between the Island Authorities and overseas authorities in investigating suspected financial crime (including fiscal offences);

The willingness or otherwise of the authorities to secure prosecutions;

(c) Assets and Confiscation

Collaboration between the Island Authorities and overseas authorities in tracing, freezing or confiscating assets held by suspected or convicted criminals based overseas.

(iii) Company Registrations Each Island's legislation, systems and practices for registering companies.

**Consultation and Comparisons**

In undertaking these tasks:

(a) to have regard to other examples of offshore regulatory laws, systems and practices, such as Gibraltar and other United Kingdom dependencies;

(b) To consult Her Majesty's Treasury and others as necessary.

# APPENDIX B
# REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES

## PART I

## BY ANDREW EDWARDS DETAILED CONTENTS

# APPENDIX C
# REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES LIST OF BOXES

# 1 SITUATION, AREA AND POPULATION

### 1.1 Situation

Jersey is situated off the north-west coast of France, the nearest points of the French coast being in Normandy 14 miles to the eas
Brittany 30 miles to the south. The nearest point of the English coast is 85 miles to the north.

### 1.2 Area

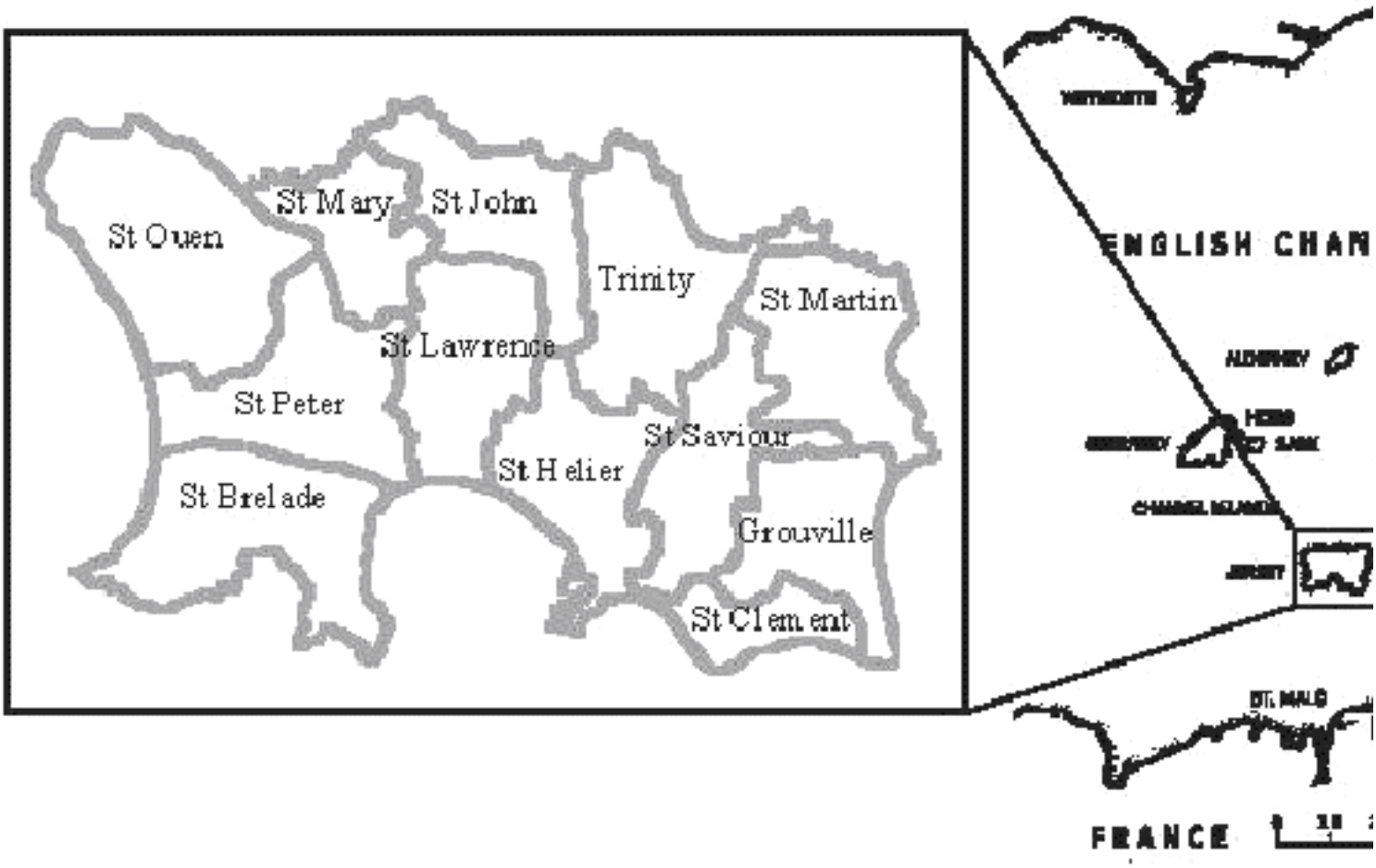
Jersey has a total surface area of 116.2 square kilometres (45 square miles).

53% of the total surface area is in agricultural or horticultural use. Headlands, valleys, dunes and water reservoirs account for a l
proportion of the remaining surface area.

### 1.3 Population

The resident population recorded by the Census held on 10th March, 1996 was 85,150. Over the period 1971 to 1996 the popula
increased by 15,820, largely through net immigration. The overall population density of the Island in 1996 was 1,898 persons pe
square mile.

The Island is divided into twelve civil parishes with almost 68% of the resident population living in the urban areas of the four s
parishes. St. Helier, the Island's capital, has the highest population density at 8,280 persons per square mile.


ENGLAND
St Mary
St John
St Ouen
Trinity
St Martin
St Lawrence
St Peter
St Saviour
St Helier
St Brelade
Grouville
St Clement
ENGLISH CHAN
ALDERNEY
HERM
SARK
JERSEY
ST. MALO
FRANCE

# 2 CONSTITUTION LAW AND JUSTICE

### 2.1 Constitutional status

Jersey, together with the other Channel Islands, was part of the Duchy of Normandy before the Norman conquest but remained in allegiance to the King of England when continental Normandy was lost in the year 1204. The Island is a dependency of the Crown. The United Kingdom is responsible for the Island's international affairs and for its defence. By long established constitutional convention the Island has autonomy in relation to its domestic affairs, including taxation.

### 2.2 Relationship to the British Crown, the United Kingdom and the European Union

By constitutional convention Jersey, like the other Channel Islands and the Isle of Man, has autonomy in its domestic affairs and the United Kingdom Parliament does not legislate for the Island without its consent on such matters. Jersey is not represented in the United Kingdom Parliament and does not form part of the United Kingdom. As set out above, the United Kingdom is responsible for the Island's international affairs and for its defence. The Island is consulted before any international agreement entered into by the United Kingdom is extended to cover the Island.

The Island has a special relationship with the European Union provided by Protocol 3 to the United Kingdom's Treaty of Accession to the European Community. This relationship cannot be changed without the unanimous agreement of all the Member States of the Community. Under Protocol 3, the Island is part of the customs territory of the Community. The common customs tariff, levies and other agricultural import measures therefore apply to trade between the Island and non-Member countries and there is free movement of goods in trade between the Island and the Community. However other Community Rules do not apply. Implementation of the provisions on the free movement of persons, services and capital is therefore not required, and the Island is not eligible for assistance from the structural funds or under the support measures for agricultural markets.

### 2.3 Parliament and the electoral system

The Island's Parliament is known as the States of Jersey ("the States"). It consists of 53 elected members comprising 12 senators (elected on an Island wide franchise), 29 deputies (elected on a Parish or district basis) and 12 constables who sit ex-officio by reason of their office. The constable is the head of a Parish. Elections are held every 3 years although senators are elected for a 6 year term with half of the senatorial seats being up for election every 3 years.

### 2.4 Executive

The States serves as both the legislature and the executive although much of the executive function is delegated to Committees comprising seven members of the States. Each Committee has responsibility for a particular area, e.g. finance, health. The senior Committee is the Policy and Resources Committee which has responsibility for the co-ordination of the policies of the States and for constitutional matters. The Finance and Economics Committee has an important rle in relation to finance sector activities. It is the Committee responsible for Customs and Excise and also has political responsibility for the Financial Services Commission which, from 1st July, 1998, assumed responsibility for financial regulation. This function had previously been undertaken by the Finance and Economics Committee itself. The Defence Committee is responsible for the police.

The Committees are supported by a permanent Civil Service consisting presently of 1,827 persons. Civil Servants are under a duty of impartiality and may not take a public part in any political matter.

**LEGISLATURE**

| | |
|---|---|
| Parliament: | The States of Jersey |
| Elected members: | 53 |
| Electoral System: | 12 Senators elected by simple majority Island constituency<br>29 Deputies elected by simple majority Parochial constituencies<br>12 Constables elected by simple majority Parochial election |
| President (Speaker): | The Bailiff |
| Leading Committee: | Policy and Resources Committee President Senator Pierre Horsfall Members (including the President) 7 |
| Legislative responsibility for financial services: | Finance and Economics Committee President Senator rank Walker Members (including the President) 7 |

### 2.5 Legal system

The Bailiwick of Jersey has its own legal and judicial systems.

Jersey customary law (equivalent to common law) is derived from Norman law. Whilst the criminal law of the Island was originally much influenced by Norman law, it has in recent times drawn on English law. Commercial law is heavily influenced by the common law principles of England but is not identical. For example the law of contract is much influenced by Norman and French principles. In areas such as property, succession, etc., Jersey law is very different to English law. In relation to financial regulation and matters dealing with the pursuit of international crime Jersey law consists predominantly of statutory law which is based on the equivalent statutes of the United Kingdom.

### 2.6 Legislation

Legislation is generally proposed by the Committee which has responsibility for the area covered by the legislation although private members may also bring legislation to the States. Primary legislation requires approval by the Privy Council in London before it enters into force. The main legislation relating to financial regulation, fraud and money laundering is listed with brief annotations in the Annex.

### 2.7 Judicial system

Jersey's judicial system differs in several respects from the English system.

The Island's principal court, known as the Royal Court, consists of the Island's Bailiff (or his substitute, see below) sitting with between 2 and 12 Jurats (see below).

The Bailiff combines the rle of Chief Judge of the Island with being First Citizen and Speaker of the Island's Parliament, known as the States. He is supported by a Deputy Bailiff. Both the Bailiff and the Deputy Bailiff are appointed by the Crown

after consultation with the Island Authorities.

The Bailiff is entitled to appoint other Judges of the Royal Court (known as Commissioners) and there are at present 2 resident Commissioners. The Bailiff may appoint persons from outside the Island, mainly QC's from the United Kingdom, as Commissioners to hear particular cases when pressure of business or conflicts of interest require. The Magistrate's Court is staffed by 2 legally qualified Magistrates supplemented by Relief Magistrates who are practising members of the Bar acting part-time. The Magistrate's Court may deal with all offences where the penalty imposed does not exceed 6 months imprisonment or a fine of 2,000. All other criminal cases must be decided by the Royal Court.

There are 12 Jurats of the Royal Court appointed by an electoral college consisting of the members of the States and the legal profession. The Jurats hold office until the age of 72 and are elected for their ability.

They are permanent members of the Royal Court and the office takes up a substantial proportion of their time. The Jurats are the judges of fact and the Bailiff (or Presiding Judge) is the judge of law. In criminal cases it is the Jurats who determine sentence. The Court sits either as the Inferior Number (Bailiff and two Jurats) or the Superior Number (Bailiff and not less than five Jurats).

Customary law offences (equivalent to common law offences in England) are tried before the Bailiff and a jury in much the same way as in the English Crown Court. Statutory offences are tried by the Inferior Number of the Royal Court. Many financial offences have been constituted by statute and would therefore be triable before the Inferior Number. However, whether a financial crime would be tried before the Inferior Number or a jury would depend upon the nature of the charges in the particular case. In the view of the Insular Authorities the Inferior Number is a suitable court for trial of complex frauds and avoids some of the problems of trial by jury in such cases.

The Appeal Court of Jersey and Guernsey is drawn from English, Scottish and Irish QC's appointed by the Home Secretary after consultation with the Lord Chancellor's Department and the Jersey and Guernsey Authorities.

The final Court of Appeal is the Judicial Committee of the Privy Council in London.

**JUDICIARY**

| | |
|---|---|
| Bailiff appointed by the Crown | Sir Philip Bailhache |
| Deputy Bailiff appointed by the Crown | Mr Francis Hamon |
| Magistrates: | |
| appointed by the Royal Court | 2 permanent, 5 relief |
| Jurats: | |
| appointed by electoral college | 12 |

### 2.8 Prosecution system

The Attorney General is the Island's Public Prosecutor. He is independent of the Legislature and the Executive. Appointed by the Crown, he is responsible to the Crown rather than to the States and serves in addition as Legal Adviser to the Crown in respect of Jersey law. He also gives legal advice to the States. He is assisted by a Solicitor General (also appointed by the Crown), 7 Legal Advisers (including 3 Crown Advocates) and 4 junior assistants. The Attorney General, the Solicitor General and the Crown Advocates employed in the Department all work exclusively on public business. Other advocates are hired as necessary to conduct prosecutions.

**PUBLIC PROSECUTORS**

| | |
|---|---|
| Attorney-General appointed by Crown | Mr Michael C St J Birt QC |
| Solicitor-General appointed by Crown | Miss Stephanie C Nicolle QC |
| Crown Advocates | 3 |
| Other qualified | lawyers 4 |

### 2.9 Conflicts of interest

The Bailiff, Deputy Bailiff, Attorney General and Solicitor General are expected not to retain commercial interests such as directorships. The Jurats may and sometimes do retain such interests. They declare their interest and do not sit if that interest might impinge on the case before them. Elected members of the States (including the president and members of the main Committees) may retain any commercial interests but, under Standing Orders which are publicly available, there is a compulsory register of Members Business Interests which is open to public inspection. The Register must include all directorships, any company in which the member or the member's spouse, singly or jointly own more than 10% of the issued shares, any land other than the principal place of residence which is owned by the member or the member's spouse or both jointly and from which either derives an income and any paid employment of the member. Standing Orders also require that members do not participate in meetings of the States or of any Committee where they or their spouse have a financial interest in the matter under discussion. Civil servants may not engage in any trade, profession or employment without the consent of the Establishment Committee (the Committee responsible for personnel matters). Where a civil servant has occasion to deal with any matter in which he has an interest, the Civil Service Rules provide that he must disclose that interest to the head of his department or, in the case of the head of a department, to the relevant Committee of the States. Failure to comply with any of these requirements would render the civil servant liable to dismissal.

# 3 ECONOMY AND FINANCIAL INDUSTRY

### 3.1 The Island's economy

The Island presents a favourable economic picture with:

- an unemployment rate of less than 1%;
- a balanced budget;
- no public debt;
- a strategic reserve equal to one year's tax income.

This performance is the result of the sound economic policies the States of Jersey have pursued over many years.

Not all aspects of the local economy however are within the States control. The Island is in monetary union with the United Kingdom and interest rates and the sterling exchange rate are the same as for the United Kingdom.

Most of the Island's imports are obtained from the United Kingdom and this means that the rate of inflation in the United Kingdom is generally mirrored in the rate of inflation in the Island. However, the Island has its own inflationary pressures arising from the pressures of a successful economy on limited land and labour resources. As a result the rate of inflation in the Island is currently somewhat ahead of that in the United Kingdom, and significantly ahead of that of the European Union average. For June 1998 the Jersey inflation rate at 4.7% can be compared with the equivalent UK rate of 3.7% and the European Union rate of 1.6%.

The performance of the United Kingdom economy has a considerable influence on the Island. Some 80% of the Island's tourists come from the United Kingdom. Also when the sterling exchange rate is strong the Island's tourism industry finds it more difficult to market in the countries of Europe that are of increasing importance as a source of visitors; and vice versa when the sterling exchange rate is weak.

For the finance industry with its world-wide appeal the external influences are global. The creation of private wealth world-wide gives rise to a growing demand for the offshore services the Island provides. In other cases it is the conditions of economic and political uncertainty that prevail that give rise to a search for a secure refuge such as Jersey. Both influences have been evident in the recent past and can be expected to remain so for the foreseeable future.

The Island has an agricultural industry marketing produce of the soil almost entirely in the UK market, and a dairy industry which enables the Island to be self sufficient in the supply of liquid milk. The Island has only a small manufacturing sector. The fiscal and natural environment of the Island is attractive as a place of residence to residents of the United Kingdom and elsewhere. The taking up of residence in the Island is subject to restriction under housing regulations whereby the purchase or lease of residential accommodation is subject to an applicant satisfying the Insular Authorities that consent is justified on grounds of essential employment or of economic/social benefits. Those in the latter category who are granted consent make a significant contribution to the Island's economy through their purchasing power and the tax revenues arising from the taxing of the investment income from abroad received by those concerned.

The strength of the economy however depends in large part on the performance of the finance industry. Many firms in this sector are experiencing strong business growth, and through the employment of school leavers and graduates the industry remains a key to maintaining good employment prospects for the Island's young people. The strength of the Island's role as an international finance centre is also reflected in the continued evidence that Jersey is the preferred location for business on the part of many institutions of international stature.

One way of showing the success of the Island's economy is to compare it with that of other Islands off the coast of western Europe. Most of the Islands off the coast of western Europe are characterised by relatively high unemployment, emigration, per capita income that is significantly below the average for the adjacent mainland, a relatively poor range of public and private services and poor transport links, and a call upon central government for financial support. Jersey by way of contrast has relatively low unemployment, per capita income above the average for the United Kingdom, good transport links and an impressive level and range of public and private services without any need to call upon the United Kingdom or the European Union for financial assistance.

### 3.2 National income estimates

Current estimates of GDP are shown below. These are based on information drawn from a number of sources. Data is available for tourist expenditure, and export earnings of agriculture. Information on incomes is available from income tax data. Considerable difficulties however are experienced in assessing the contribution of the finance industry to GDP in common with other countries where financial services are significant in scale and involve transactions with non-residents.

The GDP calculations have been used to-date simply to monitor change over time and as a guide to the contribution the individual sectors of the economy make to the Island's national income to assist in policy formulation.

**Table 1**

*GDP and GDP per head*

| *Year* | *GDP, m* | *GDP per head,* | *as % of UK GDP per head* |
|---|---|---|---|
| 1980 | 345 | 4570 | 111 |
| 1985 | 610 | 7650 | 121 |
| 1990 | 1050 | 12575 | 129 |
| 1995 | 1280 | 15095 | 125 |
| 1996 | 1350 | 15850 | 125 |

**Table 2**

Contribution of main industries and services to GDP 1996

| | *Per cent* |
|---|---|
| Finance and related services | 55 |
| Tourism | 24 |
| Individual/Investment Holders | 14 |
| Agriculture | 5 |
| Manufacture for Export | 2 |

The above figures should be treated with caution. Jersey's national income estimates are currently under review as part of a comprehensive economic/environmental model building project involving the Fraser of Allander Institute of the University of Strathclyde. The Institute initially will produce an input/output table for Jersey, a full social accounting matrix and a set of national accounts derived from the matrix including gross domestic product and gross national product estimates. The Institute will then undertake a full analysis of the structure of the Jersey economy using a social accounting matrix model of the economy. It will include a full analysis of the linkages within the economy. Finally, the Institute will undertake intensive policy simulation covering sectoral, fiscal, labour market and sustainability impact studies.

### 3.3 Public expenditure

Public expenditure (gross revenue and capital expenditure)-covering central and local government-represented 32% of GDP in 1996. Income tax accounts for some two-thirds of public sector income and 90% of total tax revenues. For 1997 total States gross revenue expenditure was 363.5 million, total capital expenditure was 94 million, total tax income was 268 million and the States long term strategic reserve at the end of 1997 was 272 million. The main elements of current budget strategy are-

- To develop long term budgets and financial management strategies which support the strategic policies of the States;
- To maintain a balanced budget;
- To maintain the standard rate of income tax at 20%;
- To develop greater equity in the tax system;
- To maintain adequate reserves;
- To develop, where appropriate, the principle of "the user pays".

The budget supports a high level of expenditure on essential public services-health, education, social benefits and housing-and service standards compare favourably with the UK and Europe generally (e.g. examination results at both GCSE and GCE levels continue to be above the UK average).

### 3.4 Currency

The States of Jersey issue notes and coins. In 1997 the total currency in circulation was 45 million in face value. While the Island will not be part of the European Economic and Monetary Union (EMU) it will be affected by it. For example, if and when the United Kingdom adopts the single currency, and Euro notes and coins replace Sterling notes and coins within the United Kingdom, Jersey will adopt the same denomination for Jersey notes and coins. Given the Island's strong trading relationship with the United Kingdom the only practical course of action is for the Island to retain the present arrangement whereby Jersey notes and coins have the same denomination as the notes and coins which circulate in the United Kingdom which are also accepted for transaction purposes within the Island.

The purpose behind issuing Jersey notes and coins is not to create a tradeable currency which would have an exchange relationship with other currencies. It is to satisfy the monetary needs of Island residents for transactions within the Islands.

Although the Island will be outside EMU and not directly affected by the monetary policy actions of the European Central Bank, Euro exchange rates and interest rates will have an impact on the Island. At the present time United Kingdom monetary policy determines the interest rates that prevail in the Island. If and when the United Kingdom joins EMU interest rates will be determined by the monetary policy of the European Central Bank and the foreign exchange rate will be influenced by the monetary conditions prevailing in Europe rather than in the United Kingdom.

### 3.5 Finance industry

The Island's finance industry has grown considerably over the past thirty years. In 1968 bank deposits totalled 200 million (or 2.3 billion in 1998 money values). In March 1998 bank deposits were close to 100 billion. Banking and other finance centre activities in 1968 were estimated to account for less than 10% of the Island's national income and tourist expenditure for over 50%. In 1996 financial services were estimated to account for over 55% of national income and tourism for less than 25%. In 1968 there were just over 1,000 employees in banking and finance (or 4% of the total workforce). In December 1997 the figure was closer to 10,000 or some 20% of the total workforce.

### 3.6 Employment

Of the total employed in the finance industry the general breakdown is as follows-

| | |
|---|---|
| Banking | 4,700 |
| Financial intermediation* | 2,900 |
| Legal activities | 1,200 |
| Accounting and related activities | 1,600 |

*Includes fund management and trust and company administration.

In the early years the Island needed to call largely upon skills from outside the Island. Jersey has now built up a resource of highly qualified personnel experienced in providing a wide range of financial services. Through a high level of productivity and the general efficiency of operations the Island is also a lower cost centre than many other centres with which it can be compared in Europe.

The Island has a limited labour market. Opportunities exist for limiting the demands on the labour force through investment in information technology and through the establishment of managed banks or trust companies administered by other financial institutions, and through the use of the Island as a front office location with back office activities located elsewhere.

### 3.7 Business activity

Some of the boosts to the Island's development as an international finance centre over the past thirty years were-

- The decision of the United Kingdom Government to redraw the boundaries of the Sterling area in 1972 which left Jersey as one of only a few offshore centres, and certainly the most substantial, within that area;
- The removal of exchange controls by the United Kingdom in 1979 which opened Jersey up to international business without restrictions;
- The buoyant international investment climate, particularly in the 1980's, which is reflected in the growth of collective investment funds from 600 million in 1980 to 38 billion in 1998;
- The growth of the world economy and private wealth which is reflected in the growth in the funds being managed in Jersey to a total now well in excess of 200 billion.

In the early years of the Island's development as an international finance centre the Sterling area was the main source of business. Through time the Island has become increasingly international in scope. The range of activities has also expanded considerably over the past thirty years reflecting this international spread of business and the main areas of business now include-

- Personal and corporate banking services;
- Global custody and securities services;
- Treasury operations;
- Mutual fund management and administration;
- Trust and company administration;
- Investment management and advice;
- Bond note and securitisation issues;
- All classes of insurance and re-insurance;
- Pensions and employee benefits;

- Accountancy and legal services.

The main reasons why business is attracted to Jersey can be summarised under six main headings-

Stability
political, economic and fiscal (reflected in Standard & Poors 'AAA' Sovereign rating).

Respectability
selection of business, institutions of stature, comprehensive and up-to-date legislative framework, international regulatory standards.

Security
secure 'constitutional' relationships with UK and EU, confidentiality for legitimate business through customary law.

Fiscal
Standard income tax rate of 20%, no capital taxes, no VAT, trusts and companies owned by non residents may be exempt from Jersey income tax.

Flexibility
speed of response to market needs, government/industry 'partnership', approachability of government.

Quality
quality of service reflecting skills/experience of the work force, the judicial system, high standard of international communication links, proximity to City of London and other European finance centres.

### 3.8 Company incorporation

For the year 1997 the analysis of new Jersey company incorporations is as follows-

| | | |
|---|---|---|
| Trustee, finance and mutual fund companies | | 270 |
| Private investment companies | | 1759 |
| Jersey residents | 85 | |
| Other British Isles residents | 692 | |
| Residents outside British Isles | 982 | |
| Trading companies | | 1327 |
| Jersey residents | 353 | |
| Other British Isles residents | 243 | |
| Residents outside British Isles | 731 | |
| Total | | 3356 |

Total live companies as at December 1997 were 32,272

The international business company (IBC) is particularly attractive to those engaged in inter-company finance, treasury operations, the management of large fiduciary accounts and the booking of international loans. Owners of IBCs come from countries as wide apart as Switzerland, United States, Middle East, France, South Africa and the Netherlands. There are currently in excess of 100 IBC's.

### 3.9 Banking

The policy is to licence banks that are, or are wholly or partly owned by, banks within the world's top 500 by reference to capital size. In June 1998 there were 79 banking licenses comprising 47 subsidiaries and 32 branches. These licenses apply to institutions from 17 different countries and 22 of the world's top 100 banks have licensed banking undertakings in Jersey. Total deposits in June 1998 were 99.8 billion of which 37.9 billion was in sterling and 61.9 billion in currency. Five of the top ten US banks are licensed as are the top ten United Kingdom banks and the top banks in each of the following countries- Switzerland, Canada, Germany, Ireland, Israel, the Netherlands and Spain.

The analysis of bank deposits for June 1998 shows the following picture for the residence of depositors.

| *Percentage of Total* | *Sterling* | *Currency* | *Total* |
|---|---|---|---|
| Jersey Resident Depositors | 4.1% | 2.7% | 6.8% |
| Jersey Financial Intermediaries et al | 4.2% | 3.5% | 7.7% |
| UK., Guernsey & I.O.M. + unallocated | 12.7% | 6.7% | 19.4% |
| SUBTOTAL | 21.1% | 12.8% | 33.9% |
| Other EC Members | 2.2% | 5.4% | 7.6% |
| European Non EC Members | 3.4% | 28.7% | 32.1% |
| Middle East | 1.0% | 6.2% | 7.2% |
| Far East | 1.1% | 2.5% | 3.6% |
| North America | 1.1% | 3.0% | 4.1% |
| Others, Unallocated non Jersey, UK | 7.9% | 3.4% | 11.3% |
| SUBTOTAL | 16.8% | 49.2% | 66.1% |
| TOTAL | 37.9% | 62.1% | 100.0% |

### 3.10 Collective investment funds

An estimated 38 billion of invested funds was placed in publicly available funds as at 30th June 1998. There were 334 public funds with a Jersey permit holding functionary and just over half of these are constituted as multi-class umbrella funds with a number of separate investment pools-all with specific investment objectives and attributes-totalling over 1,100. Many funds have listing on the London Stock Exchange or on other exchanges around the World. Funds in the recognised class which are subject to standardised rules on matters such as investment restrictions, valuation and so on are automatically freely marketable to the general public in the United Kingdom, Japan, Ireland, Hong Kong, Australia, the Netherlands and Switzerland. Fund managers from the United Kingdom, Switzerland, France, USA, Australia, Sweden, Germany and several other countries have been accepted by the Jersey Authorities as having the appropriate standing and substance to launch Jersey based funds.

### 3.11 Limited partnerships

There are a considerable number of new private Jersey collective investment funds being developed taking the form of limited partnerships. These have one or more general partners (who have unlimited liability) and one or more limited partners whose liability for debts and obligations is limited to the amount of their contribution. Limited partners are generally passive investors and do not usually take part in the management of a limited partnership. The partnership structure is generally looked through for taxation purposes and is particularly attractive for institutional investors and especially in the context of investment in less conventional underlying assets such as venture and development capital situations, management buyouts and real property.

### 3.12 Insurance

The introduction of the Insurance Business (Jersey) Law 1996 allowed a further diversification in the business able to be undertaken by Jersey authorised and registered insurance companies. For the first time, companies in Jersey were able to conduct third party insurance, including particularly life and pensions business, in addition to the existing captive and reinsurance business. There are signs of increasing growth in this area. Since the Law was enacted the total number of offshore insurance companies has increased to 15 which comprise special purpose vehicles for securitisation of risks, and insurers carrying on long term (life and pensions) business, as well as captives.

### 3.13 Loan issues

Jersey has become increasingly attractive in connection with the establishment of offshore vehicles to raise finance for banking or trading groups by, for example, Eurobond issues, commercial and Euro commercial paper issues and medium term note facilities. The Island has also been granted by Standard & Poors a "AAA" ceiling rating for such bond and note issuing companies established in the Island.

### 3.14 Commercial trust

Jersey companies are often combined with trust structures particularly in connection with the placing off balance sheet of various assets and Jersey is becoming a favoured jurisdiction for securitisation programmes. Besides the more common use for personal and financial planning, trusts are increasingly used in structuring corporate transactions of various kinds and are particularly useful in connection with offshore employee benefit programmes. Such programmes include the establishment of pension schemes, international employee stock ownership plans, bonus and deferred compensation structures and international staff programmes and payroll. The total assets under trust administration are estimated to be well in excess of 100 billion.

The Jersey trust has particular appeal, and the Island's trust law has been copied by many other jurisdictions. As the concept and advantages of an Anglo-Saxon trust have become more recognised world-wide so the pressure has increased on financial institutions providing private banking and investment services, many of which are based in Switzerland, to provide a trust formation and administration service in the Island. It is accepted that if such a service is to be provided it is preferable for it to be based in a jurisdiction such as Jersey where the concept of a trust is well established, there is good statute law and the courts and the professionals are all familiar with the concept.

### 3.15 General

All sectors of the finance industry are supported by some 25 legal firms many of which are very experienced in international financial activities. Jersey has also offices of all the big five accounting firms plus a large number of medium sized and small firms.

Over 30% of the top 500 European companies and over 10% of the top 700 companies in Asia-Pacific are already making use of the Island's facilities.

The Island's business development has benefited from the fact that it is offering financial services within the European time zone. Many of the world's major financial institutions are based in Europe. While they are servicing clients world-wide there are clearly advantages for those institutions in terms of management control and accessibility if the offshore centre being used is in Europe. Also many resident in countries where English is their first or second language find the Island a particularly attractive location. This includes those resident in the countries of the Far East where considerable wealth has been generated in recent years.

The Island's attractions to corporate and individual investors world-wide is based on constitutional, political and economic stability with fiscal attractions, flexibility with a sound and comprehensive framework of legislation, investor protection with innovation, enterprise with professionalism. In a small Island of 85,000 people and 45 square miles in area the Island

combines many of the features of larger centres such as Switzerland and the City of London in a small package. Above all the Island's attraction as an international finance centre has been based upon its standing and reputation as a stable, professionally sound and well respected centre, offering a quality service that is responsive to market needs.

The Island's success as an international finance centre of stature is not only of benefit to the Island community. It also benefits the UK-

- Of the 200+ billion worth of funds managed in the Island, over 150 billion is estimated to be invested in or through the City of London, of considerable benefit to financial institutions and professional firms in the City.

- Jersey makes a significant contribution to the United Kingdom's balance of payments.

- Almost all of the goods consumed in the Island are imported from the United Kingdom. Therefore the success of the Island's economy reflected in the expenditure of Island residents, and also the expenditure of tourists, benefits UK manufacturers and suppliers of goods and services and those whose employment this trade supports.

- Many foreign investors are encouraged to invest in the United Kingdom through the use of a Jersey company. Through limiting their exposure to UK taxation, particularly inheritance tax, the net return is enhanced and investment encouraged to the advantage of UK residents through the employment generated.

- To the extent that capital is exported from the UK to Jersey to take advantage of legitimate tax saving opportunities, it is generally returned to the UK for investment. If funds were 'exported' further afield this return would be less likely to occur.

# 4 TAXATION

### 4.1 Policies

The main policies affecting taxation are

- to retain the standard rate of income tax at 20%
- to maintain balanced budgets
- to hold reserves broadly equivalent to one year's tax receipts.

The Island's low tax status and its history of fiscal stability have stemmed from the Island's political stability. The Island's fiscal attractions have been maintained in part from prudent housekeeping (there is no government debt and capital projects are generally financed out of income, rather than borrowings) and in part from the business growth that has been stimulated by appropriate economic policies.

### 4.2 Direct taxation

Income tax was introduced in 1928 and, except for a brief period in 1934/35 remained at 2.5% until 1940 when it was increased to the present level of 20%. The income tax year is the calendar year. The rate of tax, on both personal and corporate income tax, and the general provisions regarding tax, have remained unaltered for over 50 years and the Island's economic policies are directed at maintaining this position. Income tax represents 90% of States tax revenues and of the total charge to income tax the distribution for 1997 was as follows:

| | |
|---|---|
| Self employed/ individual investment holders | 13% |
| Employees | 26% |
| Companies | 61% |

Of the income tax payable by companies, the greater part is accounted for by the finance industry.

### 4.3 Taxation of residents

The Income Tax Law charges to tax individuals and corporate bodies resident in the Island in respect of their income from all sources both within and outside the Island.

The basis of assessment is the income of the year of assessment, except in the case of trading profits which are assessed by reference to the accounting year ended in the preceding year.

### 4.4 Collection of income tax

The tax assessed is payable in one sum on the day following the issue of the notice of assessment and notices are normally issued in the year following the year of assessment. In the cases of cessation of residence, dissolution, death etc., the notices

are issued as soon as the assessments have been computed. There is no Pay-As-You-Earn or similar system in operation and tax on remuneration from employments is directly assessed and payable in one sum, in the same way as other sources of income. Arrangements may be made for payment by monthly direct debit. Because of high tax thresholds 37% of the total individuals assessed for tax are exempt from income tax.

### 4.5 Taxation of non-residents

Individuals and corporate bodies not resident in the Island are charged to tax on income arising to them from sources within the Island.

As in the United Kingdom there exists a long-standing concession that the tax liability on local bank interest arising to non-residents is not pursued. Neither is the tax on Old Age and similar Pensions paid by the Employment and Social Security department to non-residents.

### 4.6 Particular vehicles

Information about particular vehicles is to be found as follows:-

| *Vehicle* | *Chapter* |
|---|---|
| Companies | 9 |
| Partnerships | 10 |
| Trusts | 11 |

### 4.7 Indirect taxes

The States of Jersey Customs and Excise department collect two categories of indirect taxes, Customs duties and Excise duties.

1. Customs duty Goods arriving directly from third countries are charged duty as specified in the European Community's Common Customs Tariff.

2. Excise Duty Excise duty is currently charged on these categories of goods:

- Tobacco products
- Alcohol
- Fuel for road vehicles

The type of goods liable to duty and the rates of duty are determined by the States of Jersey.

10% of tax revenues is accounted for by indirect taxes covering alcoholic goods, tobacco products and motor spirits plus a small element of duty on imported goods.

The excise duties as a percentage of the UK duty rate from December 1997 are as follows:-

| | |
|---|---|
| Spirits | 70.5% |
| Wines | 58.0% |
| Beers | 39.0% |
| Cigarettes | 46.0% |
| Cigars | 50.0% |
| Leaded Petrol | 37.0% |
| Unleaded Petrol | 36.0% |
| Diesel | 36.0%% |

### 4.8 Other taxation

There are no higher rates of tax on income (or surtax), no capital gains taxes, no estate or inheritance duties, and no value added tax.

Stamp duty is levied on property transactions. Parish rates are levied upon owners and occupiers of property but rates are low by comparison with United Kingdom rates because major services (e.g. education, police, fire service etc.) are financed from central revenues.

The overriding principle of taxation in Jersey is that to which reference was made in the report by the European Commission on "Taxation in the European Union" - "That the best conditions for enterprise lay in taxation systems that were as simple, fair and effective as possible. Over recent years the trend has been towards broadly based systems at generally low rates of tax. These were generally thought best suited to promoting continuing economic growth, and preferable to a series of particular tax exemption or deductions targeted at individual business sectors or niches."

# 5 FINANCIAL REGULATION POLICIES AND STRUCTURES

### 5.1 Government policy and responsibilities

The Island of Jersey has a policy of regulating its finance industry to international standards and its regulatory legislation and framework is broadly similar to the UK save that the Island has always had a single regulator responsible for the entire finance industry.

In 1994/95 the States of Jersey undertook a major review of its policies. The review was co-ordinated by the Policy and Resources Committee, the Island's senior Committee, and included a major consultation exercise with residents and businesses in the Island. The Committee held nearly 60 meetings with a wide variety of groups and some 16,000 questionnaires were completed by Island residents and analysed by MORI. The outcome was a comprehensive statement of the Strategic Policy Objectives for the Island to which all, whether in the public or private sectors, could have regard and incorporate into the planning of their own areas of responsibility. The policies were incorporated into a document titled "2000 & Beyond-Strategic Policy Review 1995" and were approved by the States of Jersey on 13 September 1995.

In addition to general policies, specific policies were agreed in relation to:-

- Population and immigration
- Environment
- Economy
- Social
- Quality of life
- International relationships
- Public sector Specific policy objectives in relation to the finance industry were enshrined in the Economy section of the Report. The objectives agreed were:-
- to strengthen further the Islands reputation as a high quality international finance centre through legislation, promotion and the development of local skills;
- to increase the overall contribution of the finance industry to the economy;
- to encourage the further diversification of the industry;
- to ensure that the industry has adequate resources to support the desired further strengthening of the industry and its diversification;
- to ensure that appropriate resources are available to provide for the effective supervision of the industry.

An action plan was also approved which included the following:-

- to enact new financial services legislation and introduce amendments to existing collective investment funds, trust,

insurance and companies legislation, to give support both to the business potential of the Island as an international finance centre and the protection of the reputation of the Island;

- the Finance and Economics Committee to be requested to take the steps considered necessary to ensure the supervisory authority is appropriately staffed and resourced to accommodate new business proposals and maintain high standards of business practice.

The action plan for financial services had been influenced by the Finance and Economics Committee ("the Committee") which had been giving consideration to whether a Financial Services Commission would be appropriate for the Island to undertake the role of regulator rather than the existing political Committee. Following the "2000 & Beyond" debate therefore the Committee sought the approval in principle of the States to the establishment by statute of a Jersey Financial Services Commission ("the Commission").

The Jersey Financial Services Commission was finally established on 4 June 1998 and the functions previously exercised by the Committee were transferred to the Commission on 1 July 1998. For the remainder of this Chapter and following Chapters the Commission is referred to in terms of how regulation is conducted in Jersey even though up until June 1998 the functions were performed by the Committee through the Financial Services Department ("FSD").

### 5.2 Related jurisdictions/comparison with UK regulation

In general the legislation and policies of the Island in financial services matters follow those of the UK. In addition, the Island has provided since 1981 the Chairman of the Offshore Group of Banking Supervisors and is a member of that Committee (which is sponsored by the Basle Committee on Banking Supervision). As such and as a member of the International Organisation of Securities Commissions ("IOSCO") the Island's policy is to comply with the international standards expected for banking and securities supervisors respectively. The Commission is also a member of the International Association of Insurance Supervisors ("IAIS") and the Offshore Group of Insurance Supervisors ("OGIS").

### 5.3 Regulatory authorities

*Legislation and terms of reference*

The Financial Services Commission (Jersey) Law 1998 was registered by the Royal Court of Jersey on 8 May 1998, came into effect on 4 June 1998 and the Commission took on its full responsibilities on 1 July 1998 from the Committee.

The Commission Law:-

- constitutes the Commission as a statutory body corporate;
- sets out its duties, responsibilities and functions;
- sets out its powers and authorities;
- outlines the basic structure of its board;
- fixes its main internal operating rules;
- allows delegation by the Commission;
- exempts the Commission from taxation;
- deals with financing;
- allows for the appointment of staff and sets out the arrangement under which existing employees were transferred;
- requires annual audited accounts and reports to the Committee and to the States;

- allows the Committee to give policy directions to the Commission;
- extends the limitation of liability of the Committee to the Commission except in the event of bad faith;
- details changes to legislation previously administered by the Committee.

The Functions of the Commission are set out in Article 5 of the Law as:-

> (a) the supervision and development of financial services provided in or from within the Island;
>
> (b) promoting the Island as a centre for financial services;
>
> (c) providing the States, any Committee of the States or any other public body with reports, advice, assistance and information in relation to any matter connected with financial services;
>
> (d) preparing and submitting to the Committee recommendations for the introduction, amendment or replacement of legislation appertaining to financial services, companies and other forms of business structure; and
>
> (e) such functions in relation to financial services or such incidental or ancillary matters as are required by or under any enactment or as the States may, by Regulations, transfer.

The Commission's promotional role is in fact an education and communication role and is not directed towards the promotion or endorsement of any particular business or product. Through brochures, seminars, guidance notes and press releases the Commission highlights the attributes of Jersey as a finance centre including its stable political and fiscal regime, its constitutional status, its relationship with the UK and EU, its communication links, its regulatory structure and investor protection provisions and, as they are introduced, details of new legislation.

Article 7 of the Law sets out the particular guiding principles which must motivate the Commission in exercising any of its functions. This Article requires the Commission in particular to have regard to-

- the reduction of the risk to the public of financial loss due to dishonesty, incompetence or malpractice or the financial unsoundness of persons carrying on the business of financial services in or from within the Island;
- the protection and enhancement of the reputation and integrity of the Island in commercial and financial matters; and
- the best economic interests of the Island.

The Commission's duty, when reference is made as above to the "public", is to the "public" as a whole i.e. all clients or potential clients of the Islands finance industry both resident and non resident. This differs from most larger jurisdictions where the regulator's duty will primarily be the protection of resident depositors and investors.

*Independence and accountability, including annual reports*

The Commission is a statutory body corporate which gives it a similar but not identical status to a limited liability company. It is able to exercise the rights, powers and privileges and incur the liabilities and obligations of a natural person of full age and capacity. Its Chairman is required to be a member of the Finance and Economics Committee and all Commissioners are appointed by the States of Jersey on the recommendation of the Committee. The Commission by virtue of Article 20 of the Law is obliged to keep proper accounting records and to submit annually its report and independently audited accounts to the Committee for onward transmission to the States.

Under Article 11 of the Commission Law the Committee may give guidance and directions to the Commission:-

> "(1) The Committee may, after consulting the Commission and where it considers it necessary in the public interest to do so, give to the Commission guidance or give in writing general directions in respect of policies to be followed by the Commission in relation to the supervision, development and promotion of financial services in the Island and the manner in which any function of the Commission is to be carried out.

(2) It shall be the duty of the Commission in carrying out any of its functions to have regard to any guidance and to act in accordance with any directions given to it by the Committee under this Article."

"Guidance" is not binding and "directions" can only be "general". It is likely that "guidance" and "directions" will be given to the Commission in relation to other policies of the States which the Commission is expected to have regard to or follow such as those relating to population and immigration policies. No "guidance" or "directions" have as yet been given.

*Links with government/parliament*

In addition to its Chairman being a member of the Committee and members of the Commission being nominated by the Committee and appointed by the States, the Committee is also responsible for taking any legislation forward to the States on the recommendation of the Commission as the Commission itself has no legislative powers. In a small jurisdiction such as Jersey, with a high dependence on one industry, namely the finance industry, a measure of "ministerial" political involvement in the Commission has been considered desirable because of the industry's strategic importance to the Island's economy. The Island also has a culture of democratic accountability being achieved through political representation on such bodies. The smooth and successful establishment of the Commission was in part achieved because the States had the comfort of such representation to safeguard the interests of the Jersey resident public at large.

*Links with UK regulators*

The Island has close links with UK regulators as well as regulators from other jurisdictions. It has designated territory status under Section 87 of the UK Financial Services Act 1986 for the marketing of collective investment schemes into the UK and under Section 130 of the same Act in respect of life assurance business. The Commission plans to enter a Memorandum of Understanding with the Financial Services Authority and with the London Stock Exchange. In addition staff from the Commission receive training with the UK regulators and meet regularly with UK counterparts.

*Accreditation and reviews*

The Commission has appointed consultants to undertake a comprehensive strategic review of its work in the remainder of 1998. The review is expected to take at least six months and is expected to make recommendations regarding the strategy and structure the Commission requires to best meet its objectives.

*Board appointments and composition*

The first Commissioners appointed to the Jersey Financial Services Commission are:-

Chairman-Senator Frank Walker, President of the Finance and Economics Committee;

Colin Powell OBE, Chief Adviser to the States of Jersey;

Jurat John Tibbo*, retired banker and Jurat to the Royal Court of Jersey;

Crown Advocate Julian Clyde-Smith, Senior Partner with a Jersey law firm;

Richard Pirouet, recently retired Senior Partner in Jersey of a big five accountancy firm;

Andrew Winckler*, previously Chief Executive of the UK Securities and Investments Board; and

Richard Syvret*, Director General of the Commission.

In addition, the Commission has appointed Richard Pratt as Director General Designate with effect from 12/10/98. He will replace Richard Syvret as Director General with effect from 1/1/99. Richard Pratt has been Director of External Affairs at the London International Financial Futures and Options Exchange (LIFFE), responsible for international regulatory issues, and

previously headed the Securities and Markets Team at the UK Treasury.

Commissioner appointments other than those marked with an "*" are for periods not exceeding three years from 4/6/98. Those so marked are for a period of 18 months from 4/6/98. Upon expiry of such period a Commissioner is eligible for re-appointment. Article 3 of the Law requires that Commissioners shall include:-

- persons with experience of the type of financial services supervised by the Commission;
- regular users on their own account or on behalf of others, or representatives of those users, of financial services of any kind supervised by the Commission; and
- individuals representing the public interest.

The Article goes on to provide that the composition of the Commission shall be such as to secure a proper balance between the interests of persons carrying on the business of financial services, the users of such services and the interests of the public at large.

*Conflicts of interest*

A Commissioner is required to disclose any direct or indirect personal interest in the outcome of the deliberations of the Commission in relation to any matter. He is required to disclose the nature of his interest at a meeting of the Commission. The disclosure is to be recorded in the minutes and he is required to withdraw from any deliberations of the Commission in relation to that matter and not vote upon it. In addition to these requirements which are contained in a Schedule to the Law itself, the Commission has approved a conflicts of interest Policy Statement which is based on similar Policy Statements of the UK regulators and which has been made public. Under the policy Commissioners have to report in writing to the Secretary of the Commission any holdings or transactions in shares or debentures held by the Commissioner, his spouse, or minor child beneficially either directly, or indirectly through trusts or body corporates, in any regulated businesses or their holding companies, subsidiaries or sister companies. Directorships of any company on the part of the Commissioner or his spouse also have to be disclosed, amongst other matters.

*Board and management structure*

The only executive on the board is the Director General. However, the other Directors and senior managers of the Commission attend Commission meetings as required. The Commission is presently organised into six divisions and the Director of each division plus the Director General form the Executive Board.

*Who decides individual cases and licences?*

Generally individual cases and licence decisions are decided by the Directors and Director General of the Commission in accordance with policies set by the Commission and under delegated authority from the Commission. The only licence decisions which have not been delegated relate to the admission of a new bank to the Island or the revocation of a licence under any of the Laws. The cancellation of Collective Investment Fund permits is delegated in certain circumstances. The Commission will also consider any appeal made to it by someone aggrieved by a licencing or supervisory decision of a Director or the Director General. Ultimately aggrieved parties have a right of appeal to the Courts.

*Frequency, preparation and recording of board and management meetings*

Commissioners meet monthly and business is conducted on a formal basis with an agenda and papers distributed a week in advance. Minutes are agreed and signed by the Chairman and full recording takes place in a minute book of Commission decisions. Likewise an Executive Board meeting takes place monthly again with a formal agenda and minutes. In addition more informal executive meetings take place on a weekly basis to keep up to date with current events.

*Staff numbers and resources*

The Commission presently has an authorised complement of 44 with 39 staff in post. Two of the five vacancies are presently being actively filled and the remaining 3 have been identified for the proposed Fiduciary and Administration Business Law (see Chapter 10). In addition the work of the Commission is supplemented by utilising resources based in the UK such as the regulatory unit from a top five accountancy firm for some of the technical supervisory requirements for a number of stockbrokers in the Island. In addition lawyers and accountants from both inside and outside the Island have from time to time been appointed inspectors to conduct investigations of behalf of the Commission. This use of outside resources can add significantly to the resources of the Commission and provide flexibility and expertise to the Commission in a way which would not be possible with established staff.

The States is of course committed, as indicated in its strategic policy objectives for the finance industry outlined in paragraph 5.1 above, to ensure that appropriate resources are available to provide for the effective supervision of the industry.

*Numbers, qualifications and experience of professional staff*

Eleven of the current staff hold professional qualifications there being:-

- seven qualified Accountants (including one who is also a Chartered Secretary and another who is also a member of the Institute of Bankers);
- two further Chartered Secretaries (including one who is also a member of the Institute of Bankers);
- two further members of the Institute of Bankers.

Three further staff are presently studying for Securities Institute qualifications. Three of the five vacancies have been identified as requiring professional qualifications. The professional staff of the Commission have a variety of backgrounds and experience in both the public and private sectors and in the UK and Jersey. The Director General although due to retire at the end of the year has been in post for 19 years and has experience in both the public and private sectors in Jersey. Of the five regulatory directors two have UK and Jersey public sector experience, one has UK private sector experience, one has Jersey private and public sector experience and one has only Jersey public sector experience. Four of the remaining five professional staff have both private and public sector experience in Jersey.

*Organisation*

The Commission is presently organised into six divisions. This is due for review later this year as consultants are being appointed to conduct a strategic review of the Commission. The present divisions are (together with total complement and number of professionally qualified staff):-

| *Division* | *Complement (In Post)* | *Professionally Qualified* | *Professionally Qualified Vacancies* |
|---|---|---|---|
| Director General | 2(2) | 1 | |
| Financial Business Divisionincluding Investment Business, Trust and Company Administration business and general Insurance Intermediary business | 8(5) | 6 | 3 |
| Insurance Division | 2(2) | 1 | |

| | | | |
|---|---|---|---|
| Banking Division | 6(6) | 1 | |
| Investments and Securities DivisionCollective Investment Schemes, Securities and Note issues | 12(11) | 5 | |
| Registry Divisionincluding registers for companies, limited partnerships, limited liability partnerships and business names | 9(9) | 2 | |
| Support Services Division | 5(4) | | |
| TOTAL | 44(39) | 16 | 3 |

*Documentation*

The Commission issues a number of documents comprising guidance manuals for the various pieces of legislation, policy statements, newsletters, information material and press statements.

*Enforcement*

Enforcement is conducted by the staff of the Commission with the outside assistance of lawyers and accountants in relation to investigations and for specialist work. The Director of each division is responsible for enforcement matters in relation to his area of responsibility for both licence holders and non licence holders. There is no separate cross-Commission enforcement section.

The regulatory laws of the Commission all have a comprehensive range of enforcement powers covering requests for information and documents, the appointment of inspectors to conduct investigations and entry and search provisions. A breach of such laws in many cases is a criminal offence and when a breach is discovered the matter is investigated and referred to the Attorney General's office for consideration and prosecution if desirable. In addition the laws will soon all provide for the Commission to make public statements regarding any breach.

The Commission is monitoring developments in the UK with regard to the Financial Services Authority ("FSA") and in particular the intention that the FSA be given fining and prosecution powers. The Commission is giving consideration to recommend to the Committee that such fining powers should be granted to the Commission, particularly in relation to fixed penalty fines for minor breaches such as the late filing of accounts. However the Commission do not foresee its powers being extended to include criminal prosecution powers preferring instead to rely on the central prosecution service provided by the Attorney General and his staff.

Additional comment on this subject is provided in the various regulatory sections.

*Filing and information systems*

The Commission is moving towards a single financial services group filing system, where all the files relating to one group are held together running from an ultimate parent file and organisation charts at the highest level through to individual licence or permit files. A common coding system is being developed and the Commission has an information system strategy which will provide for the flexible development of its information systems to match the complexities of the financial services industry and its regulation in the Island. In this regard following a tendering exercise a contract has been entered into with a computer services company to develop a central indexing system which will form the basis for a fully integrated regulatory system for the Commission. In addition work is nearing completion on a Document Imaging System for the Companies Registry which will provide both staff and members of the public with access to electronic images of company files in the Register of Limited Liability Companies.

*Financing*

The Commission is financed through fees levied on those it regulates. In addition, the Commission Law provides for the States if necessary to pay a grant to the Commission or for the Commission to borrow money in its own right. The broad policy of the Commission is for each division to cover its costs from the fees it raises.

### 5.4 Broad approach to regulation

*Coverage of regulation*

The Commission currently regulates:-

- banks;
- insurance business; and
- collective investment fund business.

It also administers the registers of:-

- companies;
- limited partnerships;
- limited liability partnerships; and
- business names; and is responsible for
- the assessment of probity of such registrations and entities; and
- the granting of consents to bond, note and securitisation issues from the Island.

It also has responsibility for sundry matters connected with regulation, for example:-

- investigating insider dealing matters;
- applying in certain cases for a "Declaration en Desastre" (Insolvency/ Bankruptcy);
- receiving beneficial ownership change declarations for Jersey exempt companies; and
- approving reinsurance arrangements in relation to the Jersey Mutual Fire Insurance Society.

An Investment Business Law to regulate stock brokers, investment advisors and discretionary investment managers was approved by the States on 2 June 1998 and will be in force by the end of the year.

A draft Fiduciary and Administration Business Law to provide for the regulation of trust companies, company formation agents and administrators, nominee companies and custodians will be available as a consultation document before the end of the year. Law drafting time has been allocated for this and for a law to regulate intermediaries in respect of general (i.e. non-life) insurance business.

Hopefully by the end of the millennium all parts of the Island's finance industry will be subject to ongoing regulation and supervision.

*Guidance notes*

Guidance Notes and Policy Statements together with general information material are issued and seminars are organised in relation to all regulatory legislation. In addition the Commission is responsible for the development of guidance notes in

relation to the Island's Proceeds of Crime (Jersey) Law. Examples of guidance notes include:-

- A guide to the Banking Business (Jersey) Law 1991 and its implementation;
- Banking Business (Jersey) Law 1991-Information for prospective applicants;
- Insurance Business (Jersey) Law 1996-Information for prospective applicants;
- Jersey-The offshore insurance centre;
- Jersey as a collective investment funds ("CIF") centre-a guide for persons wishing to base a CIF operation in Jersey;
- Guidance note on open-ended unclassified funds;
- Circulation in Jersey of offers for subscription, sale or exchange of securities originating outside Jersey;
- Jersey incorporated companies;
- Limited Partnerships (Jersey) Law 1994;
- Establishing a Jersey Trust Company; and
- Jersey-on trusts and trustees.

*Off site and on site*

Regulation in Jersey is a mixture of off site and on site. Annual returns, accounts and in the case of some businesses, monthly returns are monitored off site by the Commission or in some cases outside professionals on behalf of the Commission. External auditors are under an obligation to report to the Commission any breaches of the regulatory laws they come across in discharging their normal audit responsibilities. They can also be called upon to investigate and report on any matter to the Commission, this provision having been used regularly in relation to banks (see Employment of outsiders in Chapter 6). On site visits, conducted by Commission staff are a feature of banking and collective investment scheme regulation and will in future also be a feature of investment business regulation, in some cases using outside professionals. A general policy of risk assessment is being developed to determine the frequency and nature of on site visits for investment business.

*Use of outside professionals*

As indicated above, the Commission, particularly in specialist areas and for investigations, uses outside professionals both from the UK and the Island. These professionals work closely with Commission staff ensuring that the Commission keeps abreast of new developments. The skills of Commission staff are further enhanced through these working relationships.

*Protection of investors*

The Commission's principal aim is the protection of investors both resident and non resident, and it is recognised that it is through this aim that the integrity and reputation of the Island as a high quality international finance centre is also protected. In relation to banking and insurance the general policy is to monitor the prudential position of the businesses and ensure they are controlled and operated by fit and proper persons. The Commission does not at present see its role as monitoring individual banking clients and the service they receive. For collective investment fund and investment business conduct of business aspects are monitored in addition to prudential supervision and fitness and properness assessment.

Jersey has a compensation scheme for recognised collective investment funds but not for other areas nor does it have an ombudsman although the Commission investigates complaints and provides a mediation service. Both issues of compensation schemes and an ombudsman are due for further consideration by the Commission in the near future.

*Relationship with other regulators*

The States of Jersey has recently approved, in the Investment Business Law and in amendments to the Banking, Insurance and Collective Investment Fund Laws, new powers and provisions to extend further the Commission's existing co-operation with overseas regulators. These reflect the latest international standards for cross border co-operation. The powers in the Investment Business Law, for example, provide for the Commission to:-

- impose, revoke or vary conditions;
- refuse or revoke a registration;
- obtain information and documents;
- conduct an investigation; and
- apply for a search warrant;

at the request and on behalf of an overseas regulator and to communicate information arising to such a regulator.

The Company Securities (Insider Dealing) (Jersey) Law 1988 also provides for an investigation to be conducted by the Commission on the request of an overseas regulator or authority. Five such investigations have been undertaken, four within the past two years.

The Commission maintains close contact with regulators from around the world. It has Memorandums of Understanding or less formal agreements with many regulators. As Chairman of the Offshore Group of Banking Supervisors, a member of IOSCO, the Enlarged Contact Group, IAIS and OGIS (see below) representatives of the Commission meet with their counterparts from around the world on a regular basis.

*Confidentiality and disclosure requirements*

Information obtained by the Commission under its regulatory laws is subject generally to a statutory duty of confidentiality within each law. However, the laws provide for the disclosure of such information in certain circumstances such as to the Police or to the Attorney General with a view to investigations or prosecutions in criminal matters, or to overseas regulators as referred to above where relevant to their regulatory responsibilities.

The Commission's duty of confidentiality also extends to information provided to it by overseas regulators. This enables such regulators to co-operate more effectively with the Commission in the knowledge that regulatory intelligence is protected.

*Financial crime, money laundering and suspicious transaction reporting*

The Commission seeks to enforce the suspicious transaction reporting arrangements on the part of those businesses which it licences. The proposed Proceeds of Crime (Jersey) Law will impose a statutory duty on the Commission itself to report suspicious transactions.

**5.5 International bodies and conventions**

- Jersey has held the Chairmanship of the Offshore Group of Banking Supervisors for the last 17 years;
- Jersey has been an associate member of IOSCO (The International Organisation of Securities Commissions) for a number of years and became a full member at its conference in Taiwan in 1997;
- Jersey is also a member of a standing IOSCO working group (no 5 of the Technical Committee) which looks at matters relating to collective investment schemes;

- Jersey is a member of the Enlarged Contact Group, a group of collective investment fund regulators from a number of jurisdictions, both onshore and offshore, who meet once a year to discuss issues of mutual concern or interest;

- Jersey is a member of two international organisations in connection with insurance-the International Association of Insurance Supervisors ("IAIS") and the Offshore Group of Insurance Supervisors ("OGIS");

- Jersey became a party to The Hague Convention on the Law Applicable to Trusts and on their Recognition on 1 March 1992.

### 5.6 Memorandums of understanding

Jersey has Memorandums of Understanding with a number of regulators from several jurisdictions as well as less formal agreements on matters of co-operation. It is the Commission's policy to enter into a Memorandum of Understanding with the banking supervisors in every country where a bank has its headquarters and also with every territory in which a Jersey licenced and incorporated bank has a branch or subsidiary. A number have also been entered into in order to facilitate the marketing of Jersey collective investment schemes into other jurisdictions and further ones are planned, details being included in the relevant regulatory sections in Chapters 6 and 7.

# 6 BANKING BUSINES

### 6.1 Policy

The objectives with regard to the authorisation of new banks is threefold-

(i) the protection of depositors;

(ii) the protection of the Island as an International banking centre; and

(iii) the protection of the best economic interests of Jersey.

These are enshrined in Article 9 (1) (d) of the Banking Business (Jersey) Law 1991.

The Commission has a policy of only admitting banks of the highest quality and to that end restricts new banking licences to-

(a) those international banks of stature in the top 500 by Tier one capital strength;

(b) banks preferably based in and/or bringing business to the Island from an area of the world not presently well covered;

(c) those meeting the required economic benefit criteria; and

(d) banks subject to satisfactory home country supervision.

*Comparison with the UK*

The policy with regard to supervision encompasses the points raised above and endeavours to ensure that supervision is conducted in accordance with international standards, in particular those standards adopted by the Basle Committee on Banking Supervision and the UK Financial Services Authority. The restrictions above do ensure a level of quality and stature which is not a common feature in banking supervision elsewhere.

### 6.2 Legislation

The legislation relating to banking supervision is the Banking Business (Jersey) Law 1991 ("the Law"), and the associated Banking Business (General Provisions)(Jersey) Order 1991. The legislation is modelled on the United Kingdom Banking Act 1987, with the only significant differences being Jersey's requirement for the annual renewal of banking licences, the ability to impose conditions on banking licences, the absence of a deposit protection scheme (see "Conformity with EU directives" below), and the prohibition in Jersey on any Jersey incorporated company being a deposit taker anywhere in the world without a permit.

### 6.3 Resources

Jersey is primarily a "host" supervisor, therefore the resources reflect this role, although in recent years a number of banks have established structures which require a degree of "home" supervision.

There are currently 4 full time posts and 2 part time posts allocated to banking supervision, consisting of-

Director-Head of Banking Supervision
Senior Professional Assistant (Shared with the Insurance Division)
Two Compliance Managers
One Banking Analyst
One Administrative Assistant (Part time)

### 6.4 Conformity with Basle 25 Principles

The 25 principles are subscribed to and are being implemented. The law is kept under regular review and is currently being amended to develop further the powers of supervisory co-operation with other authorities and jurisdictions outside the Island in accordance with principle no.24 (contact and information exchanges).

*Conformity with EU Directives*

Under the terms of the Protocol attached to the 1971 Treaty of Accession of the United Kingdom to the European Community, EU Directives relating to Financial Services do not apply to Jersey, and Jersey is treated as a "Third" Country. However, it is the policy to follow best international practice and therefore the principles of various relevant Directives are being followed, for example-

- **EU Solvency Directive**-All recommended weightings have been adopted with Jersey requiring a higher minimum solvency ratio of 10% compared with only 8% in the EU;

- **Large Exposures Directive**- recommended limits on large exposures have been adopted by Jersey;

- **Consolidated Supervision Directive**-post BCCI directive on consolidated supervision is followed by Jersey;

- **Own Funds Directive**-principles of the own funds directive in the context of defining a banks capital for solvency purposes are followed.

Directives which are not followed entirely include-

- Money Laundering Directive-There is no requirement in Jersey to report cash transactions although other requirements will be followed under the new Proceeds of Crime (Jersey) Law;

- **Deposit Guarantee Schemes Directive**-Although the Law provides powers to set up such schemes, there are no plans at the present time to do so because average deposits in Jersey greatly exceed the limits usually set for such schemes and the quality of the local banking sector which results from restricting new licences to banks in the top 500 worldwide is high;

- **Contractual Netting**-Jersey legislation regarding bankruptcy is unclear with regard to netting and as a result plans are in hand to introduce a new specific law on netting to enable Jersey to come into line with the EU in this area. Under the terms of the EU directive in the case of a counterparty failure due to a default, bankruptcy, or liquidation all transactions must be capable of being netted to provide a single legal obligation to either pay or a claim to receive . This must be backed up by a legal opinion to the effect that the Courts in the jurisdiction governing the transactions would recognise the net sum of claims or obligations in the case of any legal challenge. At the present time the Jersey authorities have been advised that the Island's bankruptcy/insolvency legislation does not fully recognise the concept of netting-hence the proposals for a new "Netting" Law.

### 6.5 Basle preconditions

Jersey's policy is to comply fully with the Basle paper entitled "Minimum standards for the supervision of international banking groups and their cross-border establishments."

### 6.6 Licensing and structure-policies

*Licensing*

Banks are registered in Jersey in accordance with Jersey Financial Services Commission Policy (See 6.1. Policy).

A two tier authorisation procedure operates. A prospective applicant is reviewed against the policy, and against a three year business plan along with a detailed submission setting out the rationale for the application to establish in Jersey.

The application is then considered by the Commission, and if successful an 'approval in principle' is granted. The applicant is then free to make its plans to establish the operation in readiness for its formal application to the Commission. Before the formal application can be approved the home country supervisor is contacted in accordance with the Basle "minimum standards" paper and confirmation is obtained that-

(i) the home supervisor has no objection to the application; and

(ii) the home supervisor will include the Jersey operation within its consolidated supervision.

In the case of a Jersey incorporated subsidiary or a managed bank (see "Managed" banks below) then a 'letter of comfort' will be requested from the ultimate banking parent.

Once all the necessary confirmations have been received then the licence is granted.

*Structure*

Article 13 of the Law requires the Commission to be notified of any changes in shareholders/controllers of a Jersey incorporated banking subsidiary, and for the Commission to give its notice in writing that it has no objection to the change. Articles 14 and 15 enable objections to be made to shareholders and controllers.

### 6.7 Relations with home country supervisors

Excellent relations are maintained with all home country supervisors. A programme of liaison visits is in hand to all such supervisors, and to date seven of the 17 countries which have banks operating in Jersey have been visited (representing 58 of the 79 registered banks).

All "deposit taking" institutions in whatever form have to be authorised or specifically exempted under the Banking Business (Jersey) Law 1991. In fact when UK Building Societies were first permitted by the UK government to establish offshore operations the two largest at the time chose to apply to Jersey and both were authorised as "banks" under the Law. There are currently no Credit Unions in Jersey but the Committee has given approval in principle to the establishment of a Credit Union type operation in Jersey which will be set up under special provisions of the Banking Business Law.

Following the "Stockholm Accord" of 1996 whereby through the Basle Committee an agreement was reached on the development of the concept of "Cross border Supervision" as a means of assisting the home country supervisors in undertaking their duties as "consolidated" supervisors, the Committee endorsed the accord and agreed to enter into Memorandums of Understanding ("MOU") with those Home Country supervisors who have banks authorised in Jersey. To date MOU's have been signed with: UK Financial Services Authority, Reserve Bank of South Africa and the Bermuda Monetary authority. Discussions are currently in progress with Guernsey, Isle of Man, Gibraltar, and the US Federal Reserve Board.

### 6.8 Regulation of subsidiaries and branches

Subsidiaries and branches operating in Jersey are supervised in accordance with the Law and international standards.

### 6.9 "Managed" banks

A "Managed Bank" is a bank which has no separate physical presence in Jersey, but which operates through an existing authorised institution. The authorisation and supervisory procedures are identical to those of a bank with a full physical presence-there is no "*two tier status of banks*"

The Jersey authorities find managed banks acceptable for the following reasons-

- They have no physical presence, therefore place no strain on the Islands tight labour market;
- They give the new bank the ability to set up more quickly;
- They offer a "toe in the water" approach enabling a new bank to test its business plans to see whether a Jersey presence is likely to lead to the establishment of a full physical presence with all the additional cost implications.

The concept of "managed banks" should not be confused with the "brass plate" operations common in some other jurisdictions.

There are currently some 12 "managed" banks operating in Jersey.

The authorisation requirements are the same as for banks with a physical presence, with the following additional requirements-

(i) a copy of the management agreement has to be provided; and

(ii) a written confirmation is obtained from the external auditors that books and records are maintained locally to enable them to carry out their responsibilities under the Law.

The "manager" has to be a person acceptable to the Commission.

As far as ongoing supervision is concerned exactly the same procedures apply as for all other banks. In the case of subsidiaries the Directors representing the parent, and in the case of a managed branch the group's senior officer responsible for the Jersey Branch, are required to meet with the Commission at least once per year.

### 6.10 Capital adequacy

Capital adequacy for Jersey subsidiary banks is set at a minimum of 10%, which is above the EU and Basle minimum of 8%. All banks are complying with the 10% policy and the average for all banks is currently 14.8%. All solvency weightings are in accordance with Basle and EU standards.

### 6.11 Lending policies

Banking Subsidiaries are required to report on a quarterly basis all large exposures in excess of 10% of their capital base. Where the exposure is to a non bank and is in excess of 25% of capital base then the prior consent of the Banking Division is required. In the case of branches, exposures in excess of 5 million are required to be reported on a quarterly basis.

Large exposure policies are based upon those of the UK Financial Services Authority.

### 6.12 Cash flow analysis/matching of assets and liabilities

Details of the maturity of all assets and liabilities are reported to the Banking Division on a quarterly basis.

Information of each banks liquidity policy is held on file.

Jersey banks are either branches or subsidiaries of international groups and liquidity is generally managed at group level.

Many banks sole purpose for being in Jersey is to collect deposits for the group.

### 6.13 Comprehensive risk assessments

The development of risk assessment measures of banks is at the forefront of banking supervision at the present time. The US authorities have a system called CAMEL (Capital, Assets, Market risk, Earnings, and Liabilities) and the Bank of England are developing a system called RATE (Risk Assessment, Tools and Evaluation). The Banking Division is closely monitoring these developments. It has itself produced an assessment based upon the data held within its data base which is currently being developed , to include subjective measures of risk, particularly in the area of "quality of management".

### 6.14 Supervisory methods

Supervision is based around the issue of notices, receipt of prudential returns, compliance visits, annual prudential meetings with top management, liaison with internal and external audit, and close co-operation with home and host country supervisors.

Article 25(1) of the Law enables the Commission to issue notices both general (to all banks) or specific (to a particular bank). To date 6 general notices have been issued covering subjects relating to reporting requirements and published accounts. A general notice was issued to all banks in January 1996 requesting an accountants report on "know your customer/account opening procedures' The Commission does not formally approve a panel of auditors but does ensure that banks are audited by competent firms. All banks must notify the Commission of the appointment or replacement of their auditor and all such appointments have to be approved by the Commission. In accordance with Basle policy the Jersey authorities encourage Jersey authorised banks to have the same auditor as the parent. The auditors are under an obligation to report to the Commission, inter alia, where they no longer have confidence in the integrity or competence of directors or senior management of the bank.

### 6.15 Management quality

The assessment of management quality has to a certain extent to be subjective. However every effort is made to try and measure management quality and performance by means of for example-

- Careful scrutiny of all personnel questionnaires for the appointment of new directors and senior managers;
- Assessment of the management "culture" at prudential meetings-seeing their response to supervisory issues;
- Monitoring customer complaints referred to the Department for each bank;
- Monitoring management's attitude to reporting and the requests for information.

The Banking Division is considering introducing the requirement identified by the Bank of England in a recent report under which management provide an annual statement that they have complied with all requirements of the UK Act and that there were no issues arising during the year which should have been brought to the attention of the Supervisors.

### 6.16 Off-site and on-site supervision, including employment of outsiders

*Off-site supervision*

Off-site supervision is based around the analysis of quarterly prudential returns. These are produced on computer disk. Jersey was one of the first jurisdictions to use this technique. The data is checked and analysed automatically and reports produced

by the banking analyst for the compliance managers.

The quarterly reports include information on-

Balance Sheet
Profit & Loss account
Off balance sheet data
Solvency ratio calculation (Subsidiaries only)
Statement of provisions and security of loans
Fiduciary business
Deposit analysis
Lending by sector
Maturity analysis
FX exposure
Parent/Group data
Large exposures
10 largest deposits
Interest & exchange rate contracts
Analysis of placements
Certificate signed by MD or Manager

A new daily "Modem reporting " system is currently being introduced which gives daily reports on key pieces of data on an automatic on line basis. This new system will be the foundation for developing bank reporting requirements into the 21st century.

*On-Site*

Although on-site visits have taken place over the years in terms of review meetings with senior management, on-site compliance visits only commenced in 1997 following the recruitment of two compliance managers. The first round of visits concentrated on gathering information on the banks structures, controls and activities in order to establish a comprehensive set of permanent data files. In addition test checks were carried out at each bank on their account opening procedures.

Stage two is to review each bank to determine its risk profile based upon its activities and management structure. This is backed up by the review and appraisal of the regular prudential reports. The next round of visits will then be more focused on the specific activities of each bank and their perceived risk.

The US and UK models on risk assessment techniques have been looked at as part of this exercise.

Staff will also be given training with other major jurisdictions who have more experience of on-site supervisory techniques.

The objective is to conduct one annual on-site visit for each bank backed with a high level annual prudential meeting with senior management, but this will vary depending upon the size and complexity of the bank concerned.

*Employment of outsiders*

The Law is modelled on the UK Banking Act 1987 and has within it powers to require an accountants report on any matter paid for by the bank. This power is set out in Article 25 of the Law and has been used to undertake a review of all banks "know your customer" and account opening procedures, and also, selectively, for banks for which Jersey has some home country supervisory responsibilities.

**6.17 Internal management and control systems, including segregation of duties**

The first round of on-site compliance visits undertaken in 1997 included an exercise to record and document internal management and control systems and organisation and structure charts. This task identified the reporting lines both within the Jersey management structure, and also up through the group. This data will now be kept under regular review.

Segregation of duties can be a problem in Jersey especially in small organisations with 10 or less staff. This is therefore given close attention at meetings with senior management.

### 6.18 Information systems

All banks have been checked by means of a questionnaire to ensure that their information systems will be 2000 compliant. Some reviews of information systems have taken place on banks for which Jersey is the lead supervisor and further reviews will be undertaken as part of the developing programme of on-site visits. Customer complaints are also monitored to determine whether they indicate any failure in such systems.

### 6.19 Non-banking activities

Unless covered under separate legislation e.g. Collective Investment Funds (Jersey) Law 1988, only the deposit taking activities of the bank as defined by the Law are subject to supervision. However, all the activities of registered banks are monitored from the point of view of risk assessment to the bank as a whole, and no new activity can be commenced without prior consent. Generally non-bank activities e.g. trusteeship and mutual fund management is undertaken in separate companies.

Supervision in Jersey is currently based around each separate piece of legislation. e.g. Banking, Funds and Insurance, and to date has resulted in very little overlap or duplication. However, with the forthcoming enactment of the Investment business Law which is to be followed by a law to regulate trust and company administration business, overlap will occur especially with banks which provide investment advice and discretionary investment management. As a result the Commission has set up a working party to consider the development of some form of lead regulator/ co-ordinator concept in order to co-ordinate the supervision and regulation of Jersey financial institutions to ensure both the most effective use of resources, and the comprehensive and co-ordinated supervision of the whole finance industry.

There are no bank Representative Offices in Jersey. The Banking Business (Jersey) Law 1991 requires any person conducting a deposit taking activity to be registered under the Law and failure to register is an offence. Unlike the UK Banking Act the Jersey Law does not recognise the concept of a bank Representative Office. This is because the nature of Jersey as an international banking centre is based upon banks establishing themselves in Jersey to take deposits for their international clients. Representative Offices are points of contact and communication for customers and potential customers and do not take deposits. In Jersey apart from the local population all the banks clients are non resident and therefore the Representative Office concept is not particularly relevant.

### 6.20 Anti-fraud

Anti-fraud measures tend to be limited to those relating to money laundering. Guidelines have been issued on "Know your Customer" under the Drug Trafficking legislation, and these are in the process of being comprehensively updated as part of the new All Crimes money laundering legislation which is due to be enacted later this year.

On the general "anti-fraud" level, most larger institutions employ their own internal compliance officers who have formed a local Jersey Association with nearly 100 members. In addition the Commercial Branch of the States of Jersey Police issue regular warning circulars to banks on fraud issues.

### 6.21 Regulator's ability to intervene

The Jersey Banking Law has similar intervention powers to those in the UK legislation.
These include the following-

> Article 27-power to undertake investigations into the nature or conduct of business, or the ownership or control of a bank;
>
> Article 28-power to investigate unregistered deposit taking and fraudulent inducements to make a deposit.

### 6.22 Enforcement

The enforcement powers under the Law are again varied and include power to issue notices for the production of documents or reports (Article 25), power to impose licence conditions to enforce a certain course of action (Article 10), and power to prohibit adverts which are considered to be misleading. The Commission also has the ultimate sanction of refusing or revoking a licence (Article 9). There are significant powers to investigate illegal deposit taking and fraudulent inducements to deposit.

### 6.23 Oversight of Bureaux De Change

Bureaux de change in Jersey are not subject to any form of regulation under the Banking Law unless operated by a bank. However, the establishment of a self-standing bureaux de change would require a licence under the Regulation of Undertakings and Development Law and the authorities would be able to refuse such a licence on grounds relating to the protection of the integrity of the Island in commercial and financial matters. However the very small number of such offices in Jersey are only engaged in the business of changing notes from one currency to another-they do not hold deposits or conduct investment business. They do of course come within the scope of the proposed anti money laundering legislation.

# 7 INVESTMENT AND SECURITIES BUSINESS

### 7.1 Policy

The regulation of investment business in Jersey is divided between two divisions of the Jersey Financial Services Commission:-

(i) **Investments and Securities Division**-responsible for regulating **Collective Investment Schemes** (open and closed ended) and **Debt Issuing Programmes** through Jersey structures; and

(ii) **Financial Business Division**-responsible for other investment business including the introduction of a new **Investment Business (Jersey) Law** to regulate investment advisers, discretionary investment managers and stockbrokers.

*Collective Investment Schemes*

The Commission when regulating the Collective Investment Fund industry, applies the following policy:-

- **Protect users of Collective Investment Schemes.**

  Participants in Collective Investment Schemes will be protected by ensuring that such schemes and their functionaries, are subject to an effective regulatory regime of licensing and on-going monitoring and supervision.

- **Protect the Islands integrity and reputation.**

  By selectivity of those institutions that will be granted permits to operate Collective Investment Schemes in the Island, the Commission will ensure that only institutions of stature and relevant track record will operate in the Island.

- **Applying the highest international standards of regulation.**

  Regulation applied to the Collective Investment Fund industry will give effect to accepted international standards. This will include investigation and co-operation on an international level.

The Island not only applies the highest international standards of regulation but also, by its membership of working Party 5 of the I.O.S.C.O. Technical Committee, contributes to the development of those standards.

*Debt issuing programmes*

The general policy is to strengthen further the Island's reputation as a high quality and well regulated centre for the establishment and administration of such securities issuing programmes. The Commission will normally only give consent to such programmes if it is satisfied that the programme is in accord with the need to protect the integrity of the Island in commercial and financial matters and is in the best economic interests of the Island.

When considering an application to establish such a structure in the Island the Commission will have regard to:-

**(i) Type of investor to whom the debt instrument will be offered**

The Commission would not normally expect such programmes to be targeted at unsophisticated investors;

**(ii) Relevant experience and reputation**

The Commission will wish to be satisfied that the parties involved with the programme can demonstrate relevant experience in operating such structures and that they are reputable organisations that will contribute to the Island's good name; and

**(iii) Programme structure**

The Commission will wish to have sufficient understanding of the programme to be satisfied that the issuer of securities will be able to meet all its obligations and that the nature and origin of the underlying assets are not inconsistent with maintaining the Island's integrity and reputation.

*Investment Business (Jersey) Law*

The Island's Investment Business Law draws on the UK's 1986 Financial Services Act and the underlying framework is presently being developed based on the practice of the previous UK Self Regulatory Organisations and the new Financial Services Authority.

**7.2. Legislation**

*Collective Investment Schemes*

Legislation governing the regulation of the Collective Investment Funds Industry in the Island is as follows:-

(a) The Collective Investment Funds (Jersey) Law 1998 as amended (the "CIF Law")

(b) Collective Investment Funds (Recognized Funds) (General provisions) (Jersey) Order 1988 as amended (the "GPO")

(c) Collective Investment Funds (Recognized Funds) (Permit Conditions for Functionaries) (Jersey) Order 1988 as amended;

(d) Collective Investment Funds (Recognized Funds) (Compensation for Investors) (Jersey) Regulations 1988 as amended;

(e) Collective Investment Funds (Recognized Funds) (Action for Damages) (Jersey) Regulations 1988;

(f) Collective Investment Funds (Permit Fees) (no.2) (Jersey) Order 1997;

(g) Collective Investment Funds (Permits) (Exemptions) (Jersey) Order 1994;

(h) Collective Investment Funds (Unclassified Funds) ( Prospectuses) (Amendment) (Jersey) Order 1995 as amended;

(i) The Borrowing Control (Jersey) Law 1947 (the "47 Law") as amended;

(j) The Control of Borrowing (Jersey) Order 1958 (the "58 Order") as amended.

Items (b) to (h) above are subordinate legislation made under the CIF law ((a) above) and item (j) is subordinate legislation made under the 47 law in (i) above.

In the case of debt issuing structures, it is only (i) and (j) that are applicable.

The CIF Law is presently being amended so that it will be in line with the most recent regulatory legislation presently being enacted in the Island. The proposed amendments were approved by the States of Jersey on 2 June 1998.

The GPO (item (b) above) is to be replaced. It has been completely rewritten and a draft of the new GPO is presently with HM Treasury for review.

The Division also apply the following Commission policies which have been developed to give guidance in the application of the above legislation in certain areas:- Commission Policy Statement on :-

(k) Promoters of public and private collective investment funds.

(l) Security issuing programmes under the Control of Borrowing legislation.

(m) Consent to the circulation of a prospectus pursuant to Article 6 of the 58 Order.

Commission guidance notes on:-

(n) The management and control of Jersey domiciled funds.

(o) Eligible markets

(p) Establishing a collective investment fund operation in Jersey.

(q) Circulation in Jersey of offers for subscription, sale or exchange of securities originating outside Jersey.

(r) Regulatory regime in Jersey.

(s) Open-ended unclassified collective investment funds.#

*Investment Business (Jersey) Law*

As mentioned above, the Investment Business Law draws on the UK Financial Services Act but is more of an enabling piece of legislation with the detail being able to be flexibly provided by subordinate legislation and Codes of Practice. The subordinate legislation will have the force of Law whereas breaches of the Codes of Practice will not give rise to a criminal offences but they will be able to be used in a Court as evidence of best practice. A breach would still be grounds for revoking a registration and for other regulatory action.

### 7.3 Resources

*Collective Investment Schemes*

The Division has 11 staff in total including the Director.

Professional qualifications held by staff in the Division include three Qualified Accountants, two members of the Institute of Bankers and one Chartered Secretary. In addition one member of staff is studying for a Law Degree, and a second member is studying for the Securities Institute examinations.

The Division has 4 sections, namely, Authorisation; Compliance; Project Work; and Administration.

The Authorisation section, which consist of three members of staff, is responsible for the evaluation of all applications submitted to the Division for permits under the CIF Law, and for consents under the 58 Order. Also consent under Part III of the Companies (General Provisions) (Jersey) Order 1992 relating to collective investment funds and securities issuing

structures, are dealt with by the Authorisation Section.

The Compliance section also have three members of staff. They are responsible for proactive compliance visits and monitoring of all holders of permits under the CIF Law. Also, this section deals with complaints from the public.

The Project work section has one member of staff. The primary responsibility of this person is to implement the revised legislation with respect to recognised funds. Once the legislation has been completely revised, the project manager will monitor all future changes to the UK's legislation and advise on the need or otherwise for equivalent changes to Jersey's legislation to ensure equivalence is maintained on an ongoing basis.

The Administrative section provides the administrative infrastructure and support to the Division as a whole thus ensuring its smooth and efficient running.

*Investment Business (Jersey) Law*

There are intended to be three dedicated professional staff in addition to the Director for the anticipated 150 registrations under this Law. In addition certain specialist work such as the regulation of stock exchange member firms to the standards in the UK's rulebook (presently SFA Rulebook) will be outsourced to UK professional firms with the Commission retaining full responsibility for the regulation and with Commission staff accompanying the outside professionals on any visits to local firms.

### 7.4 Enforcement

*Collective Investment Schemes*

Under the CIF Law, the Commission has the power to appoint an inspector where it believes such action is advisable for the protection of the public or of participants or potential participants in a collective investment fund. The inspector can be empowered to investigate the affairs of all or any of the holders of permits relating to particular collective investment funds and to make such further inquiries as the inspector may consider necessary. (Article 19 of the CIF Law). There is also general power to require production of documents and the obtaining of information (Article 8).

In the case of companies, Article 128 of the Companies (Jersey) Law 1991 enables the Commission, on being satisfied that there is good reason to do so, to appoint one or more competent inspectors to investigate the affairs of a company and to report on them as the Commission may direct.

Inspectors appointed under the CIF Law or the Companies Law will usually be Jersey advocates or Jersey based chartered accountants from local private firms of lawyers or accountants respectively. They will work to and be responsible to the Director of the Division by whom they will be briefed and to whom they will have to report to on a regular basis.

The Division is often asked by regulators, such as IMRO, for information regarding the fitness and properness of permit holders under the CIF Law who might, for example, be wishing to undertake some form of investment business in the UK. To date, the Commission has always been able to assist and provide foreign jurisdictions with the information they require.

*Investment Business (Jersey) Law*

As indicated above, enforcement will be conducted by Commission staff with outside assistance where required. The Investment Business Law contains similar provisions in relation to enforcement as are found in the CIF Law (as outlined in "Collective Investment Schemes" above), for example inspectors can be appointed by the Commission to investigate any matter in relation to investment business.

### 7.5 Investment business services-Investment Business (Jersey) Law

The majority of the 78 banks in the Island conduct some investment business and they will require a licence under the Investment Business Law. In addition there are 12 stockbrokers, 25 investment managers and approximately 50 investment advisory businesses in the Island. Futures and options business is limited and although some banks, brokers and investment managers will conduct derivatives business on a limited and usually execution only basis, there is only one dedicated derivatives broker in the Island. It is not intended that foreign exchange business itself will be regulated under the Investment Business Law although as in the UK derivative and foreign exchange transactions for investment purposes are regarded as investments.

### 7.6 Authorisation and authorisation criteria and processes-Investment Business (Jersey) Law

Authorisation procedures and criteria are currently being developed generally following UK practice. Criteria to be met before an investment business will be registered will include such matters as:-

- qualifications and experience of investment staff;
- financial resources;
- professional indemnity insurance;
- a "four-eyes" requirement;
- fitness and properness of principal persons;
- internal control procedures;
- segregation of assets;
- directors questionnaires;

Those who apply for licences by a set deadline will be able under transitional provisions to continue trading for a period of time and the business will not actually be registered until it meets the laid down criteria. If a business is not able to meet the criteria by the end of the transitional period, which may last up to 18 months, it will have to cease trading.

### 7.7 On-going regulation and regulators ability to intervene-Investment Business (Jersey) Law

Ongoing regulation will be based on a risk assessment of each business and on other specific matters such as monthly, quarterly or annual returns, audited annual accounts etc. There will be a planned programme of compliance visits. Where concern or suspicion arises the Law provides for a number of possible remedies ranging from a straightforward request for information and documents, through appointment of inspectors and search and seizure on a Bailiff's Warrant, to revoking the businesses registration. Where necessary the Law provides for the Commission to apply to the Court to issue injunctions, to put in its own administrator or manager, to apply to make a business bankrupt or to direct the business to wind itself up in an orderly fashion. As a counter to these extensive powers the business concerned has a right of appeal where aggrieved although a direction of the Commission, other than one to wind up, still has to be complied with while the appeal is being heard.

### 7.8 Collective Investment Schemes, open-ended

*Recognized and non recognized.*

Open-ended Collective Investment Schemes will fall to be regulated under the CIF Law.

The Law provides that a person cannot, in or from within the Bailiwick be, or hold himself out to be, a functionary of a collective investment fund until he has been granted a permit by the Commission. In the case of a Jersey Company, or a Jersey Limited Partnership, a permit is required regardless of where they carry on their functions. The functions for which a permit are required are defined in Article 3 and the schedule to the CIF Law.

Permits issued under the CIF Law can be one of two categories. It can either be a "recognized" fund permit or it can be an "unclassified" fund permit.

*Recognized fund permit*

Funds for which recognized fund permits have been granted are able to market directly to the general public in the United Kingdom. Jersey has designated territory status under section 87 of the UK's Financial Services Act 1986. Jersey achieved this status by introducing subordinate legislation under the CIF Law (called the Recognized Funds legislation) which is modelled on the equivalent UK legislation. The relevant pieces of legislation that comprise the Recognized fund regime are those listed in (b) to (e) of 7.2 above. Recognized fund permits are issued to those functionaries who are able to demonstrate that they, and the fund for which they act, are in compliance with Jersey's recognized funds legislation.

*Unclassified fund permits*

Any fund which is subject to the CIF Law but is not a "recognized fund" is known as an "unclassified fund". Although the requirements applicable to an unclassified fund are broadly the same as for recognized funds, there is less subordinate legislation governing their structure and operation. It is the Commission's policy that unclassified funds be regulated to an extent and in a manner considered to be appropriate to the nature of the particular fund. This involves negotiation with the promoter and/or his professional adviser, following scrutiny of all the documentation and other information associated with the unclassified fund. This policy has been maintained and developed over the years in order to facilitate innovation by the Industry and enables the Commission to be responsive to such innovation while still protecting investors and the Island's reputation as an international finance centre.

*Recognized fund and unclassified fund permits*

Regardless of what type of permit is applied for the Commission, when considering an application for a permit, is under a statutory duty (Article 5 of the CIF Law) to have regard to the protection of the public and to the best economic interest of the Island and to this end must consider the function to be performed by the applicant, the reputation of the applicant and the collective investment fund to which his function relates. Also the Commission must take into account any other functionaries there are or may be to the collective investment fund to which the application relates.

*Authorisation and Licensing criteria*

The authorisation section of the Division, which consist of three staff is responsible, inter alia, for the evaluation of all applications for permits under the CIF Law.

When considering applications, the sophistication of the proposed investors is taken into account. The more a fund is targeted towards investors who are institutions or individuals experienced in investment matters, the more flexible the Commission can be in its regulatory requirements, relying instead on prudential aspects and adequate disclosure. There are three stages in the application process:-

(a) Initial review stage;

(b) Document review stage; and

(c) Formal licensing stage.

In addition to these three stages, promoters or their representatives often find it helpful to discuss their intentions on an informal basis with the Commission immediately before making a formal application at initial review stage.

*Initial review stage*

At this stage, the Commission needs to have a submission, in writing, giving:-

The identity of the promoters (promoting companies and any group of which they are a part) together with their most recent report and accounts and any further background information which will enable the Commission to establish their stature, reputation and track record. The Commission policy statement on promoters (item (k) in section 7.2) is applied at this point. If the promoter does not meet the requirements laid down in that policy statement the application will not be progressed.

Similar information will be required regarding other functionaries to the fund, where the function performed is considered to be material and that information is not already available to the Commission.

Also required at this stage will be general information regarding the fund, its proposed investments, its structure (equivalent in its nature and extent to information normally contained in the main parts of the prospectus), the nature of the investors and the minimum investment. In the case of an application by a proposed functionary for a non-Jersey fund (i.e. a fund established in another jurisdiction), the Commission would also wish to have an indication of the regulatory approvals which are to be forthcoming in due course from other jurisdictions.

The initial review stage will conclude with the Commission writing a letter to the applicants indicating whether or not the application can be proceeded with subject to the Commission being satisfied with the structure and documents of the proposal in due course.

*Document review stage*

This stage involves the detailed examination of the structure for the fund.

**(i) In the case of recognized funds**, the Commission wishes to receive drafts of all the material contracts (which will normally mean all those contracts detailed in the prospectus), the memorandum and articles/trust instrument of the fund, including any fund rules, or resolutions on matters such as investment restrictions, borrowing powers, valuation regulations, etc. and a copy of the draft prospectus. There must also be submitted a certificate signed by an advocate or solicitor of the Royal Court to the effect that the trust instrument/ memorandum and articles comply with such of the requirements of the GPO (see item (h) in 7.2 above) as relate to their contents. The content of the prospectus and main constitutive documents and the manner in which the fund may operate are prescribed by the recognized funds legislation. There is therefore very little room for discretion on the structure and operation of such funds.

**(ii) With regard to unclassified funds,** the Commission requires draft copies of the same documents described for a recognized fund permit. However, instead of a certificate from an advocate, the documents would need to be accompanied by a "document review checklist" this checklist lists all those regulatory matters that the Commission would wish to see

addressed in the constitutive documents to ensure adequate investor protection. We would expect the applicants to reference the checklist so as to identify where each of those regulatory requirements are addressed in the constitutive documents and if they are not addressed the reason why. The more a fund is targeted towards sophisticated investors, the more relaxed the Commission's approach would be with regard to a number of the regulatory requirements in the checklist, relying instead on prudential aspects and adequate disclosure of the risks etc. in the prospectus. However, where the fund is targeted at retail investors then the Commission would normally expect all the requirements in the checklist and sometimes more, to be compiled with.

*Formal licensing stage*

For permits under the CIF Law (recognized or unclassified), the Commission would wish to be provided with certified copies of all the material contracts, memorandum and articles/ trust instrument including fund rules and board resolutions and a copy of the prospectus in final form.

The formal licensing stage will conclude with the issue of permits, normally with conditions attached.

*Fund manager/custodian separation*

For recognized funds the requirements for separation of these two functions are to be found in Article 8 of the GPO which reads as follows:-

> "8.-(1) In the case of a recognized unit trust, the manager and trustee must be persons who are independent of each other.
>
> (2) In the case of a recognized open-ended investment company, the custodian must be a person who is independent of that company and the manager.
>
> (3) Without prejudice to the generality of paragraphs (1) and (2), in the case of a recognized unit trust of which the manager and trustee are both bodies corporate having the same ultimate holding company, which is incorporated and resident outside the Bailiwick, the manager and trustee shall be deemed to be persons who are independent of each other if the Commission is satisfied that the following conditions have been compiled with-
>
> > (a) that the manager and trustee are subsidiary companies of a corporate group with aggregate capital resources, comprising paid-up share capital and reserves, in excess of 1 billion;
> >
> > (b) that neither the manager nor the trustee is a subsidiary company of the other;
> >
> > (c) that no person is a director or other officer or employee of both the manager and the trustee;
> >
> > (d) that the trustee has undertaken to report to the Commission all contraventions by the manager of the requirements of the Law or of any Regulations or Order made thereunder (including this Order) applicable to a recognized unit trust and all breaches by the manager of the obligations imposed upon the manager by the trust deed;
> >
> > (e) that guarantees or undertakings or both, satisfactory to the Commission, of any liabilities of the trustee and the proper performance by the trustee of its obligations in respect of the recognized unit trust have been given by a holding company of the trustee.
>
> (4) Paragraph (3) shall have effect in relation to a recognized open-ended investment company as it has effect in relation to a recognized unit trust, taking references to the trust deed as references to the articles, references to the manager of a recognized unit trust as references to the manager of the company and references to the trustee as references to the custodian." In the case of unclassified funds, the same requirements would be applied. However, where it can be demonstrated that the investors are sophisticated and there is proper disclosure in the offering documents then some relaxations might be considered. For example groups with less than 1 billion capital resources have been accepted.

*Valuation and pricing*

In the case of recognised funds the valuation and pricing requirements are prescribed in Parts VIII to XI of the GPO. In the revised version of the GPO single pricing will be an option available to managers of recognized funds.

In the case of unclassified funds, the requirements are negotiated on a case by case basis, using industry best practice as the base. The more a fund is targeted at sophisticated investors the more the Commission will relax its requirements in this respect.

*Investment policies*

In the case of recognized funds the Investment restrictions with which the fund must comply are detailed in Part XIII of the GPO. For unclassified funds, again, the requirements are negotiated on a case by case basis but using the GPO requirements as the base. The level of relaxation permitted will very much depend upon the perceived sophistication of the investors.

*Reporting & disclosure requirements*

Functionaries of both recognized and unclassified funds are required to make numerous periodic reports or one-off disclosures. In the case of recognized funds functionaries, these requirements are likely to be laid down in the recognized fund legislation. For unclassified fund functionaries it is more likely to be conditions attached to the functionaries permit.

Among the reporting disclosure requirements are:-

**(a) Annual audited report and accounts of operators**

Both recognized and unclassified fund operators are required to submit to the Commission their audited report and accounts. Also the consolidated accounts of the Group to which the operator belongs must be submitted.

**(b) Periodic financial resource statements of manager and trustee/custodian**

Such statements are required from the manager and the trustee/custodian of a recognized fund. They enable the Commission to monitor the capital adequacy of these operators on an ongoing basis. The manager must submit monthly, quarterly and annual statements, the trustee/custodian annually. The Commission must be notified if the manager or trustee/custodian has or has reason to believe it will breach the requirements. The notification must specify the action to be taken to rectify the breach.

**(c) Reports by the trustee/custodian**

A Trustee/Custodian is required to report in writing to the Commission any facts within his knowledge from which it appears or might appear that the manager is running a negative box or is delaying settlement.

The manager of a collective investment scheme is required to prepare an annual report to be submitted to shareholders/ unitholders. This annual report must include a report by the trustee/custodian which states whether in his opinion the manager has managed the fund in that period in accordance with the investment and borrowing powers imposed on the manager or otherwise in accordance with the provisions of the constitutive documents and the legislation. If the manager has not done so then the report must state in what respects he has not done so. The manager is required to send a copy of the report (including the trustee/custodian's report) to the Commission when it is published.

**(d) Auditors reports**

In the case of recognized fund the annual financial resource statements of the manager (b above) are required to be accompanied by an auditors report which is addressed to the Commission. This report requires the auditor to state his opinion on a number of matters-for example whether the manager has maintained throughout the financial year systems adequate to enable him to comply with the client money regulation and whether the balance sheet and profit and loss account are in agreement with the managers accounting records. Where the auditors report is qualified in any respect his report must include a statement specifying the relevant requirements and the respects in which they have not been met.

The Commission must be notified of and is entitled to copies of any letters of weakness sent to the manager by the auditor.

The resignation of or removal by the manager or custodian of its auditor must be reported to the Commission an the report must contain a statement either to the effect that there are no circumstances connected with the resignation or removal of the auditor considered necessary to bring to the attention of the Commission or a statement signed by the auditor of such circumstances.

**(e) Prospectuses**

The Commission must be provided with a copy of prospectus on an annual basis or when changes are made if sooner.

**(f) Other various notifications**

There are a number of matters that must be notified to the Commission by operators of collective investment funds. For example:-

1. Notification of change of directors;

2. Change of any addresses;

3. Changing Group structure:

4. Change in any of the constitutive documents.

In the case of a recognized fund an operator is required to submit a report to the Commission each year specifying any change in the information originally submitted to the Commission at the time of application for a permit.

A number of the above matters require the prior consent to the Commission before they can be put into effect.

*On-going regulation and Regulator's ability to intervene*

The Division has three staff dedicated to compliance work. It consists of one senior manager and two managers. These staff carry out proactive compliance visits to all functionaries holding permits in relation to material functions such as manager, custodian, trustee, administrator.

The staff in the compliance section of the Division have been fully trained in IMRO techniques and the compliance visits they undertake are based on the IMRO format. The frequency of visits is annually for recognized fund operators and usually once every two years for unclassified fund operators.

The criteria/basis for the level of work carried out on such visits will be a risk based approach. If the risk of non-compliance is perceived to be high (for example because of complaints received or because internal control procedures are considered poor) then the level of detailed checks carried out will be that much greater.

The procedures generally used on site visits are as follows;-

**(a) Pre-visit planning**

The relevant file of the fund and functionary will be reviewed for details that will assist in the carrying out of the visit. For example, details concerning the fund would include the type of fund, whether it is open or closed-ended, the type of investor that the fund will attract and the type of investments the fund will invest in. Details concerning the functionary will include whether the functionary has breached any of the legislation during the period since the last visit and any persistent breaches such as negative boxes. The previous visit reports would be reviewed.

**(b) Progressing the visit**

The visit centres around the completion of the working papers. These papers are derived from those used by IMRO. They contain a number of tests that should be carried out on a visit. Included are tests to ensure procedures are in place to prevent and detect money laundering. The volume of testing is a decision that is taken based upon the perceived risk of error or non-compliance. The working papers are primarily designed for recognized funds but are also used for the unclassified funds substituting requirements prescribed by the recognized funds legislation for best practice.

**(c) Follow up visits**

After the management letter has been issued, a follow up visit will be organised to review the progress the functionary has made in improving internal control systems, correcting errors and so on in accordance with the Commission's recommendations. This visit will normally be carried out within three months of the main visit.

The powers of the regulator to intervene beyond that of Compliance Visits was dealt with in section 7.2 Legislation above.

**7.9 Collective investment schemes - closed-ended sector**

*Investment trusts*

Investment trusts will fall to be regulated under the CIF Law if they are being offered to the public (this being a defined term in Article 2 of the CIF Law). Generally, an offer to more than 50 persons will be an offer to the public. All the requirements described in 7.8 above for open-ended funds will then apply to such an investment trust and its functionaries.

What remains are the private offerings to a limited number of investors. Such investment trusts require the consent of the Commission under the 58 Order (see item (j) in section 7.2 above).

The 58 Order gives the Commission control, inter alia, over the issue of shares or units in an investment trust. When considering an application for consent, the Commission is required, to have regard to the need to protect the integrity of the Island in commercial and financial matters and the best economic interests of the Island.

*Protected Cell Companies*

Protected Cell Company legislation has not been enacted in Jersey. Careful consideration has been given to the matter in Jersey but it has not proved possible thus far to find a satisfactory answer to certain perceived problems.

*Authorisation/licensing criteria & procedures*

**(a) CIF Law**

For investment trusts regulated under the CIF Law the criteria and procedures are, in all material respects, the same as described in "Authorisation and Licencing Criteria" above for open ended funds.

**(b) 58 Order**

Investment trusts for which only consent under the 58 Order is required can, by definition, only be marketed to institutional/ sophisticated investors. The Division therefore takes a more relaxed view on a number of the regulatory matters concentrating more on the prudential aspects and adequate disclosure of risks etc. in the prospectus.

The initial review stage described in "Organisation and Licencing Criteria" above will be applied to investment trusts under the 58 Order also. However, depending on the sophistication of the investors the Division may take a more relaxed view on matters such as the stature of the promoter. Promotion will in any event be very restricted.

Consents issued under the 58 Order will normally be conditioned-for example, that there will be no change in the Manager, Investment Advisers etc. without the Commissions consent.

*On-going regulation and regulators ability to intervene*

For investment trusts under the CIF Law the position is as described above.

Operators of Investment Trusts for which consent only under the 58 Order has been obtained are not subject to proactive compliance visits. The Schedule to the 47 Law (see item (j) in section 7.2 above), gives the Commission powers which include the ability to have produced to it, books, accounts or other documents. The Schedule also enables officers of the Commission to enter premises in specified circumstances. Article 128 of the Companies (Jersey) Law 1991 enables the Commission, on being satisfied that there is good reason to do so, to appoint one or more inspectors to investigate the affairs of a company and to report on them as the Commission may direct.

### 7.10 Debt issuing structures

The supervisory regime over debt issuing structures is substantially the same as that described for private offerings in closed-ended collective investment schemes in 7.9 above. Such structures require the consent of the Commission under the 58 Order (see item (j) in section 7.2 above). When considering an application for a consent under the 58 Order for a debt issuing programme the Commission will have regard to the need to protect the integrity of the Island in commercial and financial matters and the best economic interests of the Island. (See also "Debt Issuing Programmes" above). Considerable attention will be given (because these are generally publicly issued securities) to the stature of all the parties involved and to the structure of the offering.

With regard to authorisation and on going regulation the position with regard to these debt issuing structures is substantially the same as that described for privately offered investment trusts in 7.9 above.

### 7.11 Regulation of stock exchange

The Channel Islands Stock Exchange is solely a Guernsey based exchange and the Jersey Financial Services Commission has no authority over it.

# 8 INSURANCE AND PENSIONS BUSINESS

### 8.1 Policy

The general policy regarding applications for permits under the Insurance Business (Jersey) Law 1996 is to ensure as far as possible:

(a) the protection of policyholders and investors;

(b) the protection of the reputation of Jersey as an international insurance centre; and

(c) the protection of the best economic interests of Jersey.

There are two broad categories of insurance business permits which can be issued under the Insurance Business Law:- Category A insurance permits will be issued to insurers which:

1. are authorised by or under the law of a jurisdiction outside of the Island to carry on business of the description in question within that jurisdiction; and

2. have provided confirmation from the relevant supervisory authority that the insurance business of any branch office, employee or agent of the applicant situated in the Island is subject to its supervision and meets all solvency and other regulatory requirements; and

3. are supervised in that jurisdiction to an acceptable standard.

Category B insurance permits will be issued to insurers which:

1. have owners which, by the provision of annual audited accounts and/or other information, have shown themselves to be of sufficient stature and reputation to be acceptable; and

2. have produced a business plan covering five years of operations showing how trading will continue successfully; and

3. have, in cases where staff are employed in Jersey, provided a projection of economic benefit satisfactory to the Island; and

4. are managed in the Island by acceptable persons who have the relevant level of knowledge and expertise in insurance business; and

5. have made, where relevant, the necessary arrangements regarding reinsurance; and

6. insure risks of a nature and type which are reasonable and appropriate.

The policy in Jersey is to make use of the annual audited accounts and supervisory returns already produced for other jurisdictions as the main way of supervising those insurers which are not registered Jersey entities (the category A permit holders). The minimum solvency margin requirements for these insurers are therefore also those applicable in the home jurisdiction.

Only the category B permit holders, which are Jersey registered companies, are subject to the Island's own reporting and solvency margin requirements. This approach is different from that in the United Kingdom, where all insurers carrying on business, wherever their home jurisdiction, must comply with the supervisory reporting and solvency requirements of the

Insurance Directorate of HM Treasury.

### 8.2 Legislation

The primary legislation is the Insurance Business (Jersey) Law 1996.

There are two pieces of subordinate legislation, the Insurance Business (General Provisions) (Jersey) Order 1996 and the Insurance Business (Solvency Margin) (Jersey) Order 1996.

The former deals with various exemptions from the Law, renewal dates for permits, the level of fees payable and (in the Schedule) the standard conditions applicable to all category B permits.

The latter sets out the minimum margins of solvency required from all Category B permit holders, as well as definitions applicable to elements of solvency calculations such as approved assets and premium income.

A Jersey incorporated company is prohibited from carrying on insurance business anywhere in the world without a permit.

Having been in operation for a little over one year, some small amendments have been deemed necessary to the primary legislation, and an amendment law has recently been passed by the States of Jersey to deal with these issues. This is expected to be fully effective by the end of the year.

### 8.3 Resources

The Insurance Division is managed by the Director-Insurance, who reports to the Director General of the Commission.

Another senior member of staff is shared with the Banking Division who also provide further assistance on an ad hoc basis, as and when necessary.

### 8.4 Enforcement

Category A permit holders are required to submit a copy of their annual audited Report and Accounts and Return to their Supervisory Authority to the Commission for review. Enforcement therefore remains in the hands of the regulator in the home jurisdiction.

Category B permit holders must submit a copy of their annual audited Report and Accounts and a solvency calculation to the Commission within three months of year end. Other reports, such as copies of reserving calculations and analyses of invested assets, will also be required. Unaudited accounts, together with a solvency calculation and the other reports, must also be submitted within three months of the half yearly point in the accounting year.

New category B permit holders must in addition submit annually a revised business plan covering the unexpired portion of the original five year plan, providing explanations of variances from the original and showing that solvency will be maintained during the first five years of trading.

Should any of the returns reveal problems, then the Commission will investigate them by holding meetings with the insurer and/or its advisers, and/or conduct an on site visit, and/ or impose additional conditions on the permit holder, as appropriate. In more extreme circumstances a formal plan of corrective action may be required.

Compliance visits may also be carried out as a routine check that the company is professionally run, that proper records are being kept and that the necessary internal controls are in place.

### 8.5 Life assurance

As at the 31st March 1998, there were 78 companies carrying on long term insurance business in Jersey under category A

permits, selling to Jersey residents, of which 60 were UK companies regulated by the Insurance Directorate of HM Treasury. The other 18 were regulated in the Isle of Man, Canada, Gibraltar, Guernsey and the Republic of Ireland.

There is one company carrying on long term insurance business under category B. It is not selling to United Kingdom residents or residents of the European Union, but to UK ex-patriates around the world.

### 8.6 Captives

Jersey has nine captive insurance companies registered under category B, all carrying on general insurance business on behalf of their parent organisations. There are no composite insurers under category B in the Island.

### 8.7 Pension funds

There are some 1,000 staff pension schemes in Jersey, and around 600 small self-administered schemes and personal pension arrangements. All these require formal authorisation from the Jersey Tax Commission under Section 131 or 131B of the Income Tax (Jersey) Law 1961, as amended, before they are permitted to commence taking contributions.

There is no regulation of such schemes other than in the context of tax matters.

### 8.8 Other

As at the 31st March 1998, there were 132 companies carrying on general insurance business in Jersey under category A permits, selling to Jersey residents and Jersey companies, of which 110 were UK companies regulated by the Insurance Directorate of HM Treasury. The other 22 were regulated in Italy, Belgium, the Netherlands, Luxembourg, the Republic of Ireland and the United States.

There are also two special purpose vehicles registered under category B. Both these companies have been formed for the securitisation of insurance risk, one to provide capacity for catastrophe reinsurance, the other for the reinsurance of mortgage default risk.

### 8.9 Authorisation/licensing criteria and procedures

In addition to a formal application form, an insurer applying for a category A permit must submit a copy of its latest annual audited Report and Accounts and Return to its home country supervisor, together with formal confirmation from the supervisory authority that the insurer is duly authorised to carry on in its home jurisdiction the classes of insurance business being applied for.

For a category B permit, the insurer must include with the application form a business plan covering the first five years of operation and the audited accounts of its parent organisation. A Directors' and Officers' Questionnaire must be completed and signed by each prospective Director and Officer to ensure as far as possible that the management of the company will be of good character and has the necessary experience and professional qualifications to manage the company. In the case of a company carrying on long term business, a fully qualified actuary must be appointed before a permit will be granted.

If, upon review of an application for either a category A or a category B permit, the Financial Services Commission feels that special conditions need to be attached, then it can do so. Such conditions can cover, inter alia, restrictions on the classes of insurance business written, insistence upon the regular receipt of detailed financial analyses of items contained in the accounts, restrictions on the type of investments which may be made, or limits on the levels of business which may be accepted before reinsurance will be required.

### 8.10 On-going regulatory requirements

All permit holders are required to notify the Commission of any proposed changes to their activities, and obtain prior written

consent. Such changes might include, inter alia, the classes of insurance business carried on, the levels or composition of reinsurance arrangements, or the composition of approved investments or admissible assets. Any changes in Directors and Officers of the company also require the written approval of the Commission following the review of the appropriate Questionnaire.

### 8.11 Solvency margin/reserve requirements

Solvency Margin requirements are laid down in the Insurance Business (Solvency Margin) (Jersey) Order 1996.

In the case of general insurance business, the required minimum margin is 17.5% of net premium income.

In the case of long term insurance business, the required minimum margin is the greater of 50,000 or 2.5% of the value of the long term business fund.

For all classes of insurance business, the reserving or valuation basis must be in accordance with such bases as are approved in the United Kingdom.

### 8.12 Permitted asset holdings

The Insurance Business (Solvency Margin) (Jersey) Order 1996 contains a list of approved admissible assets for solvency margin calculation purposes.

Additional assets may be considered admissible if requested by a permit holder and approved in writing by the Financial Services Commission. Conversely, the Commission may impose in writing total or partial restrictions on the admissibility of types of assets if warranted in respect of a permit holder.

### 8.13 Submission of annual accounts and auditing

All insurers holding a category A or a category B permit must submit annual audited accounts to the Financial Services Commission. For category A permit holders, these will be submitted within the timescale prescribed in their home jurisdiction. In the case of category B permit holders, the audited accounts must be submitted within three months of the accounting year end.

### 8.14 Public disclosure requirements

Category A permit holders must comply with such public disclosure requirements as may apply in their home jurisdiction. There are no public disclosure requirements in respect of category B permit holders.

### 8.15 Separation of assets and liabilities for life business

Category A permit holders are subject to the provisions regarding separation of the assets and liabilities relating to life business laid down in the legislation of their home jurisdiction. If none exist, the Commission has the power to impose a special condition within the permit requiring such separation in respect of Jersey business.

Article 25 of the Insurance Business (Jersey) Law 1996 requires that category B permit holders must maintain full separation of the assets and liabilities relating to long term insurance business.

### 8.16 Requirements for actuarial valuations

Category A permit holders are subject to the provisions regarding actuarial valuations laid down in the legislation of their home jurisdiction. If none exist, the Commission has the power to impose such a requirement in relation to Jersey business

through the use of a special condition attaching to the insurance permit.

Article 24 of the Insurance Business (Jersey) Law 1996 requires that all insurers holding a category B permit and carrying on long term insurance business shall appoint a qualified actuary, who shall be responsible for the valuation of long term liabilities for balance sheet and solvency margin purposes.

### 8.17 Regulator's power to intervene

Article 9 of the Insurance Business (Jersey) Law 1996 provides that the Commission may, by notice in writing, require a permit holder to provide at such time as may be specified, such information or documents as the Commission may reasonably require for the performance of its functions under the Law.

The Commission may also require a permit holder to provide the Commission with a report by an accountant or other appropriately qualified person on any aspect of the permit holder's business.

Article 10 of the Insurance Business (Jersey) Law 1996 empowers the Commission to apply to the Court for the appointment of a competent person to investigate and report to the Commission on the nature, conduct or state of a permit holder's insurance business or any particular aspect of it, or on the integrity, competence, financial standing or organisation of a permit holder.

Article 11 of the Insurance Business (Jersey) Law 1996 provides that the Commission or its duly authorised officer or agent may by written notice require a person suspected on reasonable grounds of carrying on an insurance business without the appropriate permit to provide specified information or documents to the Commission.

The Bailiff of Jersey has the power under Article 12 of the Insurance Business (Jersey) Law 1996 to issue a warrant if satisfied that there are reasonable grounds for believing that there are documents on any premises whose production has been required under Articles 9 to 11 and which have not been produced, and such warrant shall authorise a police officer to enter the premises using such force as may be necessary for the purpose of taking possession of such documents.

### 8.18 Frequency of liquidator or rehabilitator appointments

During at least the last ten years there have been no instances of a liquidator or a rehabilitator being appointed in connection with a Jersey registered insurance company.

### 8.19 Policyholder protection

There is no policyholder protection scheme similar to that operating in the United Kingdom in force in Jersey. However, the Insurance Business (Jersey) Law 1996 does contain an enabling provision in this regard.

### 8.20 Passporting

Insurance companies which are properly authorised and regulated by an acceptable overseas jurisdiction may trade in Jersey through the acquisition of a category A permit.

There is no prohibition within the insurance law preventing a Jersey registered insurance company from carrying on insurance business outside the Island. Such activity may be hindered or prevented by the laws and regulations in other jurisdictions.

### 8.21 Designation

Jersey has been designated under Section 130 of the Financial Services Act 1986 as having a regulatory regime in connection with life assurance providing equivalent supervision to that applicable in the United Kingdom. Jersey Category B permit

holders which are life assurers are therefore able on a case by vase basis to market to UK residents or through UK financial businesses.

# 9 REGULATION OF COMPANIES AND DIRECTORS

### 9.1 Company legislation

The Jersey companies legislation has a number of similarities with UK companies legislation and was broadly based on it. The legislation is continually reviewed and updated. For example, an amendment to the Companies (Jersey) Law 1991 was passed by the States of Jersey earlier this year to enable Jersey securities to be traded in electronic form. This will enable shares in Jersey companies to participate in CREST, the UK's electronic settlement system. Further amendments are due to be debated by the States later this year including provisions to deal with the Euro.

### 9.2 Types of company

Figures as supplied by Income Tax Department

| | *Registered with Commission?* | *Numbers, Jan 1998* | *Net increase from Jan 1997* |
|---|---|---|---|
| Public companies | Yes | included in the figures below | included in the figures below |
| Resident Income Tax paying companies | Yes | 15,595<br>the vast majority of which are incorporated in Jersey | 496 |
| Exempt companies | Yes | 19,371<br>of which around 3/4 are incorporated in Jersey, the remainder being incorporated elsewhere | 1,315 |
| International Business Companies | Yes | 123<br>the vast majority of which are incorporated in Jersey | 7 |
| Foreign Incorporated Investment Companies | No<br>but will have Income Tax file | 4,774 | 1,817 |
| Limited Partnerships | Yes | 82 | 31 |
| Limited Liability Partnerships | Yes | NIL | NIL |
| Other overseas | No | No records kept | No records |

| | | |
|---|---|---|
| companies administered in Jersey | | kept |
| TOTAL | 39,945 | 3,666 |

Notes: The number of public Companies included in the total of 39,945 is 255. The number of Jersey Incorporated Companies in the total of 39,945 is 32,272.

**9.3 Responsibility for licensing and regulation.**

The Jersey Financial Services Commission ("the Commission") is responsible for the registration of Jersey incorporated companies, Limited Partnerships, Limited Liability Partnerships and Business Names. The Laws do not presently require the registration of non-Jersey companies carrying on business in Jersey although the matter is due to be discussed by the Commission later this year.

The legislation is enforced by the Registry Division of the Commission supplemented by external inspectors where required. There have been two formal investigations under the Companies Law where inspectors have been appointed. In one case a Jersey advocate was appointed and in the other a Jersey-based chartered accountant was appointed.

**9.4 Jersey incorporated companies**

*Access to limited liability*

Jersey incorporated companies all need to be registered with the Registry Division of the Commission and are incorporated under legislation administered by that Division. All Jersey incorporated companies have limited liability.

*Residence test*

All Jersey incorporated companies are resident for Jersey tax purposes. (Other companies incorporated elsewhere are only resident for tax purposes where the management and control resides in Jersey).

*Requirement for local agent*

There is no requirement in Jersey for a local agent. However all Jersey incorporated companies are required to have a Registered Office in the Island.

*Access to registration*

Registration is controlled-see "Requirements other than registration" below.

*Public and private companies*

A distinction is made between public and private companies under Jersey Company Law. A public company is any company which has more than 30 members, states that it is a public company in its memorandum of association or circulates a prospectus. The vast majority of Jersey incorporated companies are private companies.

*Requirements other than registration*

In addition to registration Jersey incorporated companies require a Control of Borrowing Consent in order to issue shares.

This Consent is dealt with at the same time as the incorporation and requires a number of questions to be answered to the satisfaction of the Commission. The questions include share details, beneficial ownership details, intended activities, other Jersey registered companies the beneficial owner has an interest in and a certification by a practising lawyer or accountant that the information is correct and that the beneficial owner has no history of insolvency. The Commission has the power to refuse consents on the grounds of protecting the commercial and financial integrity of the Island. The Commission has a policy statement regarding sensitive activities which are subject to detailed scrutiny and only in exceptional circumstances will such a company be incorporated. Sensitive activities include arms, accountancy, legal, time-share, mail order, pharmaceuticals and anything to do with financial services. Frequently additional information is requested from the firm concerned before a decision is reached.

Each year approximately 3,000 companies are registered and Control of Borrowing Consents issued and in around 20 cases incorporation is not proceeded with. In addition a number of informal enquiries are dealt with which result in the process not being commenced in the first place.

In addition to the above requirements all tax exempt companies are required to notify the Commission of any changes in beneficial ownership to preserve their exempt status (see below).

| | *Public companies* | *Private companies* |
|---|---|---|
| REGISTRATION REQUIREMENTS | • Name<br>• Registered Office Address<br>• Memorandum and Articles of Association<br>• Directorsname, address, occupation, date of birth, nationality<br>• Initial subscribers<br>• Capital details<br>• Proposed activities (All public except activities) | • Name<br>• Registered Office Address<br>• Memorandum and Articles of Association<br>• Beneficial owner name, address, nationality<br>• Initial subscribers<br>• Capital details<br>• Proposed activities (All public except beneficial ownership and activities) |
| ON-GOING REQUIREMENTS REQUIRING NOTIFICATION/ APPROVAL | • Change of name<br>• Change of address<br>• Change in capital<br>• Directors<br>• Annual returnlist of members as at 1st Jan., directors details<br>• Audited accounts within seven months of year end | • Change of name<br>• Change of address<br>• Change in capital<br>• Annual returnlist of members as at 1st Jan |

*Tax regime for resident companies*

There are three types of resident companies

(i) Normal tax paying;

(ii) International Business Companies ("IBC"); and

(iii) Exempt (and thus treated as non- resident).

**(i)** Resident **tax paying** companies pay tax at 20p in the pound.

**(ii)** Resident Jersey incorporated companies may apply to be taxed as International Business companies ("**IBC**'s"). IBC's (other than some minor exceptions such as a shareholder in a public company) must be beneficially owned by non-residents (or, if owned by a resident company, that company must be wholly owned by non-residents), beneficial ownership must be disclosed to the Commission and an annual certification made to the Income Tax Department. International business profits of an IBC are taxed on a sliding scale from 2% for the first 3 million to companies:-0.5% for profits above 10 million. Local income is taxed at 30%. A minimum non-refundable tax charge of 1,200 is payable in advance of each years actual assessment. IBC's are particularly suited to large international groups for head office and/or treasury functions.

**(iii)** Resident Jersey incorporated companies may apply to be taxed as **Exempt** companies. Exempt companies must, subject to minor exceptions, be beneficially owned by non-residents, beneficial ownership must be disclosed to the Commission and an annual certification made to the Income Tax Department. The "tax" for such companies is a fixed 600 fee per annum. Any Jersey income, other than bank deposit interest, is taxed at 20%. Jersey income includes the profits of a trade carried on through an established place of business in the Island. Exempt companies are best suited for individuals requiring a vehicle in which to hold their investments. They are basically treated as non-resident for Jersey tax purposes.

*Other companies*

See 9.5 below.

*Enforcement*

The enforcement regime is covered by the Companies Law and the Income Tax Law administered by Commission and Income Tax Department respectively. The Companies Law generally follows UK principles of statutory record keeping, directors, secretaries, members registers etc. The Law provides for the appointment of inspectors where required. There have been two appointments of inspectors under these provisions.

*Insolvency*

The Island has up to date solvency legislation and a long established enforcement regime under the control of the Viscount, the Chief Executive Officer of the Jersey Courts.

The Jersey Courts have restrained assets in both internal cases and to assist courts from outside the Island.

In 1997 there were 28 declarations "en desastre" (the Jersey equivalent of insolvency).

### 9.5 Non-Jersey companies

*Policy*

As an international finance centre the Island provides a range of structures and vehicles, including non-Jersey companies, which would be expected to be found in such jurisdictions.

*Types of non-Jersey company*

The main types of non-Jersey company are:

(i) IBC;

(ii) Foreign registered exempt company;

(iii) Foreign registered investment company;

(iv) Other foreign registered companies; and

(v) Overseas company with branch in Jersey.

*Main features of each*

**(i)** A non Jersey company can elect to become an **IBC** for Jersey tax purposes so long as it meets the same requirements as a Jersey incorporated IBC (see above).

**(ii) Foreign registered exempt companies** must be beneficially owned by non-residents, beneficial ownership must be disclosed to the Commission and an annual certification made to the Income Tax Department. The "tax" for such companies is a fixed 600 fee per annum. Any Jersey income, other than bank deposit interest, is taxed at 20%. Jersey income includes the profits of a trade carried on through an established place of business in the Island. Exempt companies are best suited for individuals requiring a vehicle in which to hold their investments. They are effectively treated as non-resident for Jersey tax purposes.

**(iii) Foreign registered investment companies** may also escape Jersey income tax and the usual exempt "tax" of 600 provided that at least one Jersey resident director is in office and the company is an investment holding company, not carrying on any trade nor in receipt of any Jersey-source income, other than bank interest. Although known to the Income Tax Department these companies are not registered with the Commission and no disclosure of beneficial ownership is made to any authority in the Island.

**(iv) Other foreign registered companies** in general may be administered from Jersey but, to avoid an assessment to Jersey income tax on their profits they would, if they did not obtain IBC, Exempt or Foreign registered investment company status, need to be managed and controlled outside the Island.

**(v) Overseas companies with a Jersey branch** are non-resident but maybe liable to Jersey income tax because of the branch trading presence. They include some banks and retailers.

;
*Requirement to register*

**Foreign registered Exempt companies** require to register with the Commission by way of a disclosure of beneficial ownership and with the Income Tax Department.

**Foreign registered investment companies and IBC's** need to register with the Income Tax Department.

**Other foreign registered companies** need not register with any Jersey authority.

**An Overseas company with a Jersey branch** needs to register with the Income Tax Department and sometimes with the Commission under one of its regulatory laws e.g. if it is a bank.

*Registration and regulatory requirements*

**Exempt** Jersey-incorporated **companies** are scrutinised by the Commission in the same way as other Jersey-incorporated companies and the same requirements apply-see above. There is an additional requirement for exempt companies that any change in beneficial ownership must be advised to the Commission.

There are no regulatory requirements other than the income tax requirements noted above for **Foreign registered investment companies** or Jersey trading **branches of overseas companies** unless, in the latter case they are required for other reasons to register eg. banks.

*Tax regimes*

See above.

*Enforcement*

See above.

### 9.6 Locally administered companies registered elsewhere

*Regulation*

Locally administered overseas companies, not caught under one of the income tax headings above, do not require registration in Jersey and there is also therefore no disclosure of the beneficial owners Tax Such companies also therefore do not pay any tax in Jersey.

### 9.7 Directors

*Specific requirements of directors*

Article 74 of the Companies (Jersey) Law 1991 requires directors to act honestly and in good faith, with a view to the best interests of the company and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. No corporate directors are permitted (Article 73). Companies may delegate through powers of attorney granted by directors, as is common elsewhere. Foreign registered investment companies require at least one Jersey director.

*Disqualification criteria and procedures*

There are no set criteria for the disqualification of directors. The Companies (Jersey) Law 1991 and the Bankruptcy (Desastre) (Jersey) Law 1990 both provide for the disqualification of directors with a maximum possible disqualification period which has recently been increased from 5 to 15 years in the Bankruptcy Law and is due to be increased from 5 to 15 years in the Companies (Amendment No. 6) Law due for debate later this year. In the case of the Companies Law the Commission or the Attorney General may apply to the Royal Court and in the case of the Bankruptcy Law the Attorney General may apply to the Royal Court for a disqualification order. There has of recent times been three disqualification's, all under the Bankruptcy Law before the maximum period was increased, two of five years and one of three years.

# 10 PARTNERSHIPS

### 10.1 Policy

As an international finance centre the Island provides a range of structures and vehicles, including partnerships, which would be expected to be found in such jurisdictions.

### 10.2 Types of partnership

Limited Partnerships and Limited Liability Partnerships are recognised on the Island. At the end of May 1998 there were 107 Limited Partnerships registered. The registration of Limited Liability Partnerships is not due to commence until 9 September, 1998, the date on which the Law will come into effect.

### 10.3 Limited partnerships

From 1995 the Limited Partnerships (Jersey) Law permitted the registration of limited partnerships in Jersey. Prior to that limited partnerships based in the Island were registered abroad, mainly in Delaware.

A limited partnership is defined as "a partnership consisting of one or more persons who are general partners and one or more persons who are limited partners." The limited partnership itself is not subject to tax, resident partners are subject to tax at 20% and non-resident partners are only liable to income tax on Jersey-source income (except bank deposit interest).

A limited partnership is suitable for venture capital business and as part of the structure for funds with a small number of investors. In such cases the limited partners would be the investors putting up the money and the general partner could be the fund manager or investment firm concerned.

There is no ongoing regulatory regime for limited partnerships although some will fall to be regulated under the Collective Investment Funds Law because of their nature. The general partner may in certain circumstances need to be licensed under the new Investment Business Law. There is registration discretion for Limited Partnerships in the hands of the Commission authorities under the Control of Borrowing legislation and the Commission may have regard to the integrity of the Island in commercial and financial matters when deciding whether to grant consent leading to registration. The registration particulars of Limited Partnerships can be inspected at the Commission Registry.

### 10.4 Limited liability partnerships

The Limited Liability Partnerships (Jersey) Law 1997 will come into effect on 9 September 1998. Registration in Jersey will be required and unlike a limited partnership a limited liability partnership ("LLP") will have a legal personality of its own and be subject to income tax assessment on the profits from trading activities carried on in Jersey, if any.

All LLP's will be required to register a 5 million bond to be used solely for the benefit of creditors on the insolvency of an LLP. LLP's will be required to maintain proper accounts but an audit will not be required nor will it be necessary to publish accounts. This is the same as for Jersey private companies.

LLP's, because of the 5 million bond will only be attractive to large partnerships. Nearly all US States now have LLP legislation.

There will be registration discretion for LLP's in the hands of the Commission under the Control of Borrowing legislation and the Commission will be able to have regard to the integrity of the Island in commercial and financial matters and to the size and stature of the partnership when deciding whether to grant consent leading to registration.

### 10.5 Taxation

Partnerships, including Limited Liability Partnerships, are charged to tax in the partnership name. Where the partnership is controlled abroad, liability to tax is limited to profits from trading operations, if any, carried on in the Island.

In the case of Limited Partnerships, the partners are taxed individually. Resident partners are taxed on the whole of their share of the income. The liability of non-resident partners is limited to income arising in Jersey, excluding deport interest, and excluding trading profits unless the trading operations are carried on in the Island.

# 11 REGULATION OF TRUSTS AND TRUSTEES

### 11.1 Policy

As an international finance centre the Island has a policy of providing a broad range of structures and vehicles, including trusts, together with the supporting legislative framework and infrastructure to maintain such activities. With an internationally recognised and widely copied Trusts Law dating back to 1984, being a party to the Hague Convention on the Law Applicable to Trusts and on Their Recognition, a judicial system experienced in adjudicating on trust matters and more than 25 legal firms and 200 trust companies in the Island Jersey is one of the major trust jurisdictions in the world. To ensure the Island's high reputation continues a supervisory regime for trust business is due to be introduced in 1999.

### 11.2 Main types and purposes

The following summarises some of the reasons for using a trust: -

- To allow more than one generation to enjoy the use of a property
- To enjoy the use of property without being the legal owner and perhaps avoid or minimise income and capital gains taxes
- To provide for the orderly distribution of assets after death
- To provide for incapacitated persons
- To protect family property from spendthrifts
- To enable the centralisation and co-ordination of world-wide assets
- To avoid forced heirship provisions
- To provide anonymity
- As part of a tax planning strategy
- To provide pensions for retired employees and their dependants
- To facilitate investments through unit trusts
- As part of bond issuing or securitisation schemes
- As part of a corporate financing structure
- To raise funds for charities The following summarises the most common types of trust found in Jersey:-

**Discretionary Trusts** -This form of trust is the most flexible and that favoured by foreign settlors. It also offers a degree of protection from the forced heirship rules of other jurisdictions as the legal title to the property transferred to the trustees and they have discretion on how it is dealt with and who may benefit. The settlor may be a beneficiary, may be able to advise the trustees on his wishes and may appoint a protector to ensure his wishes are carried out.

**Interest-In-Possession Trusts** -This allows a settlor to ensure that his property can be enjoyed by more than one generation without the risk of it being squandered by the first generation. The "life-tenant" is fully entitled to any income arising during his lifetime but cannot dispose of the property. On his death the right to the property passes to the next generation who may be able to dispose of it as they please.

**Accumulation and Maintenance Trusts** -This form of trust is generally set up for children or those incapable of looking after their own affairs. The trustees will be given power to accumulate any income arising or alternatively to exercise their discretion and make payments to cover "reasonable" expenses of education and maintenance. In the case of healthy children the accumulation period generally ends on their 25th birthday after which time they may become absolutely entitled to their share of the trust property or alternatively to a life interest in the income arising.

**Purpose Trusts** -An amendment to Jersey's Trusts Law in 1996 permits the use of purpose trusts which do not require the identification of any beneficiaries and must be for a stated purpose. Such trusts are more useful for corporate entities rather than individuals.

**Charitable Trusts** -Trusts will be recognised as charitable if the purposes can be classed as the relief of poverty, the advancement of education, the advancement of religion or for any other purpose beneficial to the community.

### 11.3 Scale and growth

There are no statistics collected on the number of or value of property in trusts. However, based on anecdotal evidence it is estimated that the value exceeds 100 billion.

### 11.4 Advantages of offshore trusts

The Trusts (Jersey) Law 1984 is recognised as one of the best trust laws in the world and has been copied by many jurisdictions. One feature of the Jersey Law which professionals from outside the Island consider beneficial to Jersey is the unlimited liability of directors of corporate trustees for breach of trust by corporate trustees.

Jersey also has an extensive expertise and supporting infrastructure resulting in a quality of service in relation to trusts which can match and even exceed many onshore jurisdictions. Jersey trusts are not subject to income tax in Jersey on their income or assets if the beneficiaries reside outside the Island, except for Jersey-source income other than bank deposit interest. There is no requirement to disclose settlors or beneficiaries for tax purposes, unless either is resident.

### 11.5 Provenance

As mentioned above there are no statistics collected for trusts in Jersey. However from company formations, bank deposits, the ownership of trust companies and general business enquiries it is possible to conclude that the source of trust business is international in its widest sense. Around two thirds of bank deposits are non-sterling and more than 70% of Jersey incorporated companies in 1997 were for non-UK residents.

### 11.6 Legislation

The Trusts (Jersey) Law 1984 regulates the trusts themselves and provides for the duties and responsibilities of trustees and the role and jurisdictions of the Courts. Trust companies, like all businesses in Jersey require a Regulation of Undertakings and Development Law licence in order to commence business in the Island. Strict entry controls are applicable to new licences regarding qualifications, capitalisation, professional indemnity insurance and so on but the Law does not provide for

any ongoing supervision.

Jersey became a party to the Hague Convention on the Law Applicable to Trusts and on their Recognition on 1 March 1992.

A Fiduciary and Administration Business Law to regulate trust companies on an ongoing basis is to be introduced in Jersey next year. A Steering Group under the direction of the Commission and consisting of representative members of the industry has been formed and a draft law is expected to be available for consultation before the year end.

Jersey has an active Society of Trust and Estate Practitioner ("STEP") branch, a Jersey Law Society, a Jersey Society of Chartered and Certified Accountants ("JSCCA") and a Jersey Association of Trust Companies ("JATCO"), all of which have members engaged in trust activities. All organise training events and seminars in the Island and are represented on a number of steering groups such as the Fiduciary and Administration Business Law Steering Group. JATCO has produced guidelines for its members.

### 11.7 Registration and regulation

Their is no requirement to register trusts nor is one envisaged on the introduction of the Fiduciary and Administration Business Law.

The proposed regulatory regime under the Law will regulate the trust companies in terms of fitness and properness, prudential matters and conduct of business. Although the regime will not regulate directly the clients of those businesses, there will be an indirect effect in the context of ensuring that business is carried on in a fit and proper manner and properly safeguards the integrity of the Island in financial and commercial matters.

The deposit takers, investment vehicles and investment businesses used by trust companies will be regulated under the other relevant legislation in Jersey.

### 11.8 Enforcement

The supervision and enforcement of the Fiduciary and Administration Business Law will be carried out by the Commission. The nature of the regime will be determined by the Commission. See below.

### 11.9 Taxation

Trustees are liable to income tax on the income arising to them but by extra-statutory concession no tax is charged on overseas income and Jersey deposit interest where the beneficiaries reside outside the Island.

# 12 REGULATION OF CORPORATE, TRUST, AND INVESTMENT SERVICE PROVIDERS

### 12.1 Policy

The Commission intends to introduce a Fiduciary and Administration Business Law in 1999 to regulate trust companies, company administrators, company formation agents and custodians.

Any lawyer or accountant conducting these activities would be caught by the proposed legislation.

### 12.2 Scale and type

There are three main categories of trust and company administrator:-

(i) Trust Company with its own staff;

(ii) Managed Trust Company-managed by a number (i) company;

(iii) Company administrator/formation agent-who does not provide trust services.

There are approximately 120 companies in category (i), 50 in category (ii) and 30 in category (iii). As these companies are not presently subject to regulation there are no accurate figures. In addition the actual number of separate companies exceeds this because of group structures where a large trust group may have, for example, several companies undertaking trust and company administration business.

All new companies require a Regulation of Undertakings and Development Law License from the Finance and Economics Committee and a strict four-eyes policy applies and no sole practitioners have been able to obtain a licence to set up in the past few years. However there are still estimated to be around 30 existing sole practitioners at present providing a variety of trustee and company formation services. These will not be permitted under the Fiduciary and Administration Business Law where the four-eyes requirement will be applied, this policy already having been endorsed by the States of Jersey. In addition to the sole practitioners there are estimated to be a further 20 with 3 or less professional staff.

### 12.3 Obligation to use

There is no obligation on a client to use any particular trust company or other services provider. However a Jersey registered company cannot be incorporated without the input of a Jersey advocate or practicing qualified Jersey accountant. In addition a business would be in breach of the Regulation of Undertakings and Development Law if it undertook activities for which it was not licensed.

### 12.4 Legislation

Legislation which imposes requirements on such companies includes the Companies (Jersey) Law 1991, Trusts (Jersey) Law 1984, Borrowing (Control) (Jersey) Law 1947, Regulation of Undertakings and Development (Jersey) Law 1973 and the proposed Fiduciary and Administration Business Law.

### 12.5 Licensing and regulation

In addition to the Regulation of Undertakings and Development Law the proposed Fiduciary and Administration Business Law will provide for a comprehensive supervisory and regulatory framework for trust and company administration business. The provisions will build on the existing policies for commencing such businesses at present including minimum four-eyes direction and control, professional qualifications, experience, insurance, financial resources, independent audit, segregation of assets, internal controls and so on.

Supervisory responsibility will lie with the Commission which will have similar investigative and intervention powers to those outlined for other regulatory laws in Chapter 6. There are three vacant posts in the Financial Business Division earmarked for the Fiduciary and Administration Business Law.

### 12.6 Lawyers

*Policy*

Lawyers will be subject to regulation to the extent they conduct business under any regulatory laws. This means that they will all likely have to register under the proposed Fiduciary and Administration Business Law.

In addition legislation is to be introduced to regulate advocates and solicitors of the Royal Court and to incorporate the Law Society of Jersey.

*Numbers and kinds*

There are 27 Jersey law firms and 11 English solicitor firms in the Island.

Nearly all deal with trust and company work, usually through dedicated companies separate from the legal practice.

There are only one or two sole practitioners and only three or four have three or less professional staff.

There are approximately 200 Jersey advocates and 70 English solicitors in the Island.

*Legislation*

In addition to the proposed Fiduciary and Administration Business Law, a Legal Practitioners Law and a Law Society of Jersey Law are in the approved law drafting programme.

*Regulation*

The proposed Legal Practitioners Law and Law Society of Jersey Law will provide for the regulation of advocates and solicitors of the Royal Court. Apart from constituting a Disciplinary Tribunal for all Jersey lawyers which will have teeth, the combined effect of these pieces of legislation will mean that no-one will be able to practice Jersey law unless he has been admitted as an advocate or solicitor of the Royal Court and is a member of the Law Society of Jersey.

English lawyers based in the Island are subject to the UK regulation and discipline regime but may also be subject to further controls under the above Laws.

### 12.7 Accountants

*Policy*

Accountants will be subject to regulation to the extent they conduct business under any regulatory laws. This means that they will all likely have to register under the proposed Fiduciary and Administration Business Law.

Otherwise the Island follows the UK practice of leaving any regulation to the professional accountancy bodies. Almost all accountants in Jersey are members of one of the UK professional chartered accountancy bodies.

There is no requirement to segregate the auditing part of an accountancy business from other activities such as trust or company work. However in practice many do so.

*Numbers and kinds*

There are 50 accountancy practices in the Island including fully staffed offices of the big five.

Nearly all deal with trust and company work, usually through dedicated companies separate from the accountancy practice.

There are five or six sole practitioners and 10 to 12 with three or less professional staff.

In total there are approximately 500 qualified accountants, nearly all holding UK professional chartered accountancy qualifications there being no Jersey accountancy qualification.

*Legislation*

There is no legislation specific to accountants in place or proposed.

*Regulation*

Virtually all accountants are subject to the regulation and discipline of the UK professional bodies.

# 13 CRIME PREVENTION POLICIES AND STRUCTURES

### 13.1 Strategy

In pursuance of their objective that the Island should be an international finance centre of the highest repute, the Jersey Authorities are determined to prevent, deter and punish crime of all kinds (including fraud, money laundering, tax evasion, drug trafficking and other crimes).

To that end they have introduced an armoury of laws, regulations and enforcement practices similar to those of the United Kingdom, together with modern systems designed to maximise the chances of detection, prosecution and confiscation. They are committed to collaborating fully with authorities of the United Kingdom and other jurisdictions in pursuit of the fight against crime.

### 13.2 International conventions

Through the United Kingdom, Jersey is a party to the 1988 Vienna Convention against Illicit Trafficking in Narcotics.

Although not able to be a member of the Financial Action Task Force (FATF) set up by the seven major industrial countries and other developed countries to combat money laundering because it is a dependency of the Crown, Jersey has, by letter from the President of the Finance and Economics Committee to the President of FATF, committed to comply fully with the 40 recommendations of FATF as updated in 1996. A FATF type evaluation carried out by a team of officials from the UK and Holland in 1994 found that the legal, financial and law enforcement structures in Jersey were substantially in accordance with the 40 recommendations but recommended that the Authorities should extend offences for money laundering to include all crimes, not just drugs offences. All Crimes Money Laundering legislation, based on the UK model, is due to be passed in 1998. The only other matters noted in 1994 have been dealt with as follows. Certain minor amendments to the Island's Drug Trafficking legislation were made which then enabled the 1988 Vienna Convention to be extended to the Island. The third recommendation was that the Financial Services Department could take a more positive rle in monitoring the anti-money laundering systems of financial institutions. To this end the Department has procured independent accountants' reports from all banks regarding their account opening and know your customer policies and keeps under review the suspicious transaction procedures as well as the frequency of reporting of such transactions. The fourth recommendation was that the anti-money laundering measures should be extended to cover financial business not subject to formal supervision. This will be achieved by the Money Laundering Order referred to in paragraph 14.3 which will apply provisions similar to those in the United Kingdom to all financial businesses.

Through the United Kingdom, Jersey is a party to the OECD Convention. Jersey has chaired the Offshore Group of Banking Supervisors, which FATF supports, since its inception 17 years ago. It also co-chaired a joint group with the Basle Committee on Banking Supervision which produced a paper on Improved Cross-Border Supervision of Banks which was adopted by banking regulators world-wide in October 1996. Jersey is also a member of the Offshore Group of Insurance Supervisors.

Jersey is a member of the International Organisation of Securities Commissions and subscribes to its resolutions which, in particular, require co-operation on an international basis.

Jersey was a founding member, along with Australia, Hong Kong, Malaysia, New Zealand, Singapore, the United Kingdom and the United States, in 1995 of the International Association of Insolvency Regulators.

### 13.3 Legislation

The States' leading committee, known as the Policy and Resources Committee, oversees the Island's law drafting office. The office employs six qualified legal staff.

The main legislation relating to financial regulation, fraud and money laundering is listed with brief annotations at the annex. The legislation on the investigation of fraud and the proceeds of drug trafficking and terrorism is similar to that of the United Kingdom. There are, however, certain draft laws, notably on All Crimes Money Laundering, Police and Criminal Evidence and Criminal Justice (International Co-operation), that have not yet been passed. These draft Laws, also listed in the annex, are expected to be taken before the States later this year and in 1999, as indicated. Jersey also proposes in 1999 to bring in a new law, for which there is at present no parallel in the United Kingdom, to regulate trust companies and company formation and administration agents.

### 13.4 Investigation and enforcement systems

Jersey has a Police Force employing 340 staff, including civilians. Every officer of the rank of Sergeant and above has received management training in the United Kingdom and all specialist officers have undertaken a course of training in their specific vocation at Home Office approved training centres. Within the Police Force, there is a Commercial Branch employing 7 staff.

The Island has a Customs and Excise Service employing 53 staff. All customs officers receive professional specialist training at HM Customs and Excise Training Centres in the United Kingdom. The training covers investigation skills, specialist search courses for vehicles, vessels and aircraft, surveillance and other types of specialist training. Specialist secondments also take place with HM Customs at various ports, airports and with the investigation service.

The Police Force has a Drugs Squad comprising 10 staff and Customs and Excise have a Customs Investigation Unit, primarily targeted at drug traffickers, of 5 staff. There is a joint Police and Customs Intelligence Bureau, employing 14 staff, responsible for intelligence collation, analysis and dissemination in relation to both local and international aspects of drug trafficking. A joint Police and Customs Financial Investigation Unit, employs 4 staff and currently works alongside the Police Commercial Branch. Consideration is being given to re-aligning this Unit with the Intelligence Bureau and extending their work to include all types of financial crime and money laundering.

The Income Tax Department employs 63 staff. The Comptroller, Deputy Comptroller and Assistant Comptroller are all ex-Inland Revenue. Below them, the 12 most senior staff have all received Inland Revenue training in investigative skills. The department collects an average of 1.5 million a year from back taxes, penalties and interest. In the last ten years there have been seven prosecutions for tax fraud.

The Island is committed to providing the necessary resources for the fight against crime.

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| **Public Prosecutors** | |
|---|---|
| Attorney-General appointed by Crown | Mr Michael C St J Birt QC |
| Solicitor-General appointed by Crown | Miss Stephanie C Nicolle QC |
| Crown Advocates | 3 |
| Other qualified lawyers | 4 |

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| **Law Draftsmen** | |
|---|---|
| Law Draftsman | Mr William McGregor |
| Staff | 6 |

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**Police, Customs, Fraud and Financial Investigation Unit**

**Police**

| | |
|---|---|
| Chief Officer | Mr Robert Le Breton |
| Staff | 328 |
| Fraud Unit Head | Detective Inspector Peter Hopper |
| Staff | 6 |

**Financial Investigation Unit (FIU)**

| | |
|---|---|
| Joint Unit of Police & Customs | |
| Staff | 4 |

**Customs and Excise**

| | |
|---|---|
| Chief Officer | Mr Anthony L Renouf |
| Staff | 53 |

# 14 INTELLIGENCE

### 14.1 Access to financial information about individuals and companies

The Island has no banking secrecy law.

As in the United Kingdom, there is a common law principle whereby persons who receive information in confidence, such as bankers, accountants, lawyers and other professional advisers, have a duty of confidence. (Tournier case 1924).

The Island has, however, enacted legislation which substantially erodes the common law rules of confidentiality, especially in cases where crime (including money laundering) is suspected except with regard to legal professional privilege. In this, too, the Island has followed UK practice.

- The Attorney General has power under the Investigation of Fraud (Jersey) Law, 1991 to obtain documents and information in cases involving serious or complex fraud.

- The police have power to apply to the Bailiff for production orders and search warrants in cases involving drug trafficking and terrorism (Drug Trafficking Offences) (Jersey) Law, 1988 and Prevention of Terrorism (Jersey) Law, 1996.

- The finance industry regulatory authorities have a full range of investigation powers in connection with the industries which they regulate. These are continually being updated to reflect the latest thinking. They include power to require the provision of information and documents, power to appoint inspectors (with power for those inspectors to summon witnesses and obtain documents and information), power to apply to the Bailiff for warrants of entry and search, power to co-operate with other regulators and power to disclose to the Attorney General and the police information for the purposes of both criminal investigations and prosecutions. These powers are to be found in the relevant regulatory laws such as the Banking Business (Jersey) Law, 1991, Insurance Business (Jersey) Law, 1996 and the Collective Investment Funds (Jersey) Law, 1988. Similar powers are contained in the Investment Business (Jersey) Law which was passed by the States on 2nd June, 1998. Under the Companies (Jersey) Law, 1990 inspectors may be appointed to investigate the affairs of any company and powers are conferred on an inspector to summon witnesses and obtain documents and information. Inspectors may also be appointed under the Company Securities (Insider Dealing) (Jersey) Law, 1988 with power to summon witnesses and obtain documents and information. The appointment of such an inspector may be for the purposes of investigating insider dealing in the Island or elsewhere.

- Under the Income Tax (Jersey) Law, 1961 the Comptroller of Income Tax has power to require the production of documents by a taxpayer in connection with his tax return.

- Under the Customs and Excise (General Provisions) (Jersey) Law, 1972 the Customs and Excise has power to search premises and persons for "things" connection with imports or exports and for documents and further information to be provided. United Nations sanctions are imposed in Jersey in the same way as in the United Kingdom and the powers conferred upon Customs and Excise in this connection mirror those of HM Customs and Excise in the United Kingdom. Customs officers can also apply to the Bailiff for production orders and search warrants in cases involving drug trafficking in the same way as the police.

The Island intends to bring forward legislation to confer investigative powers in cases of other crimes (see Part B of the Annex).

### 14.2 Underground banking systems and shell companies

Power is conferred by the Banking Business (Jersey) Law, 1991 to investigate any suspected underground banking system, i.e. a person carrying on deposit taking business without a licence. Those powers include an ability to summon witnesses, demand information and documents and obtain a search warrant of premises where appropriate.

As to companies generally, the Island Authorities insist upon the disclosure of full details concerning the ultimate beneficial owner of Jersey companies upon formation. Where the Finance and Economics Committee or the Financial Services Commission is satisfied that there is good reason to do so, inspectors may be appointed to investigate the affairs of any company. The inspectors have full powers to obtain information and documents, examine persons on oath and obtain search warrants. Inspectors may also be appointed of companies incorporated elsewhere which carry on business in the Island or which have an address in the Island which is used regularly for the purposes of their business. The Committee has exercised this power where appropriate.

In 1999 the Island intends to introduce legislation regulating the providers of company administration services. The legislation is intended to minimise the risk of the misuse of companies administered in Jersey.

### 14.3 Transaction reporting by banks and others

The Island Authorities collaborate closely with banks and others with a view to identifying crime, including drugs offences, serious or complex fraud and money laundering, within the limits imposed by the current legislation (see below). A Working Group, which included representatives from industry, police and regulators, developed the Money Laundering Guidance Notes for banks and collective investment funds. A similar group under the direction of the Financial Services Department is presently developing new Guidance Notes for the All Crimes Money Laundering legislation. It is intended that a similar group should continue along the lines of the UK Joint Money Laundering Steering Group.

Like the UK, the Island has a system for suspicious transaction reporting by banks, other financial institutions, lawyers, accountants, companies and other professional practices and partnerships. The obligation to report such transactions is set out in the Drug Trafficking Offences (Jersey) Law, 1988 (as amended) and the Prevention of Terrorism (Jersey) Law, 1996.

Both the institutions concerned and individual staff have a duty of vigilance. If they do not comply they are liable to penalties of up to 5 years imprisonment. No prosecutions have been brought so far for breaches of these provisions which were introduced by amending legislation in 1997.

There are as yet no disclosure provisions in relation to offences other than drug or terrorism offences but the new All Crimes Money Laundering legislation will impose similar duties to those imposed in the United Kingdom.

Pursuant to the new legislation, it is intended to introduce subordinate legislation which will broadly replicate the UK Money Laundering Regulations which are in turn based upon the EU Money Laundering Directive. Subject to the same exemptions as in the United Kingdom, the subordinate legislation will oblige institutions to have Money Laundering Report Officers.

The disclosures are submitted to, and processed by, the Financial Investigation Unit. The Unit also runs training courses and seminars for staff in the private sector. The Unit gives feedback to those providing the disclosures unless to do so would be prejudicial to continuing enquiries.

The accompany table summarises the number of disclosures made during the past 6 years.

| *Institution* | *1992* | *1993* | *1994* | *1995* | *1996* | *1997* |
|---|---|---|---|---|---|---|
| Banks | 327 | 267 | 352 | 321 | 382 | 419 |
| Insurance Companies | | 1 | | | 4 | |
| Other financial institutions | | 3 | 5 | | | |
| Trust companies | 9 | 2 | 9 | | 5 | 8 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other companies | | | | | | |
| Lawyers | 3 | 1 | 2 | 1 | 3 | 2 |
| Accountants | 2 | 1 | 5 | 3 | 3 | 2 |
| Investment advisers | | | | | | |
| Others | 1 | | 2 | 8 | 5 | 1 |
| TOTAL | 342 | 275 | 375 | 333 | 402 | 432 |

The Island Authorities are keen to ensure that the suspicious transaction reporting system is complied with fully by all financial organisations, not just the banks.

### 14.4 Unexplained life-style

Where a person has a lifestyle beyond apparent means the law enforcement agencies are able and willing to collect and share information.

### 14.5 Sharing of intelligence

The law enforcement agencies of the Island are willing and able to share intelligence both within the jurisdiction and with agencies outside the Island.

# 15 INVESTIGATION

### 15.1 Obtaining information

For suspected crimes relating to drugs, terrorism, serious or complex fraud, and insider dealing the Island Authorities are able and willing to require information and documents at the investigation stage.

With regard to smaller frauds and other crimes, the Authorities at present have no corresponding powers. There is no law corresponding to the UK's Police and Criminal Act, 1984 (PACE). The Authorities' ability to require information and make searches in those cases is confined to where charges have been brought. There are, however, plans to introduce such powers in a new PACE Law, which it is expected will be presented to the States in 1999.

Neither existing nor prospective legislation will permit the Authorities to require documents or information in relation to unexplained life styles without some other evidence of criminal conduct, although clearly an unexplained life style may be one factor in the evidence which justifies the use of such investigative powers. In this respect the position of the Island is similar to that of the United Kingdom.

### 15.2 Sharing information inside the jurisdiction

The situation in the Island is broadly comparable to that in the United Kingdom, namely that there are statutory "*gateways*" whereby the Regulatory Authorities can in certain circumstances disclose information which they have obtained pursuant to their regulatory functions. These gateways enable the Regulatory Authorities to disclose information to the law enforcement agencies with a view to the institution of criminal proceedings. The law enforcement agencies may and do share information freely with each other and with the Regulatory Authorities.

The Comptroller of Income Tax may only disclose information for the purposes of the Income Tax Law and prosecutions in respect of income tax offences.

### 15.3 Sharing information with other jurisdictions

In cases where drug offences, terrorism, insider dealing or serious or complex fraud are suspected, the Island Authorities are able and willing at the investigation stage to require information and documents, through interrogation, production orders and search warrants and to share them with other Authorities outside the jurisdiction.

In other cases they have no powers at present either to obtain such information or to pass it to other jurisdictions unless charges have been brought, at which stage assistance can be and is given in relation to all offences (see paragraph 16 below).

The Authorities do, however, intend to bring forward a Criminal Justice (International Co-operation) Law which will enable them to share with other jurisdictions at the investigation stage the information which they themselves are empowered to require in all categories of crime. Like the new PACE Law, this is expected to be presented to the States in 1999.

The following table summarises requests made by other jurisdictions and assistance given in recent years.

**Requests made by other jurisdictions at investigation stage and assistance given (nos. of cases per year).**

| | *1992-96 average* | | *1997* | |
|---|---|---|---|---|
| | *Requests received* | *Assistance given* | *Requests received* | *Assistance given* |
| Drugs | 22 | 22 | 21 | 21 |
| Terrorism | 0 | 0 | 3 | 3 |
| Fraud | 49* | 41* | 78 | 74 |
| TOTAL | 71 | 63 | 102 | 98 |

*1993-96 average
(1992 not available).

**15.4 Mutual legal assistance treaties and double taxation agreements**

The Island is party to the Mutual Legal Assistance Treaty on Drug Offences between the United Kingdom and the United States of America which was entered into in 1988 and subsequently extended to the Island. The Island's policy is to designate all countries with which the United Kingdom has entered into a MLAT in the relevant Regulations made under the Drug Trafficking Offences (Jersey) Law, 1988 so that assistance in freezing and confiscating assets can be given in respect of such countries. The same policy will be adopted in respect of other crimes once the All Crimes Money Laundering legislation is in effect.

The Island has Double Taxation Arrangements with the United Kingdom and Guernsey. The Treaty with the United Kingdom was made in 1952 although it has been amended since then. Article 10 provides that the relevant taxation authorities may exchange such information as is necessary for carrying out the provisions of the Arrangement, for the prevention of fraud or for the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the Arrangement. It further provides that any information so exchanged shall be treated as secret and not be disclosed to any persons other than those concerned with the assessment and collection of taxes.

# 16 JUDICIAL PROCEEDINGS

### 16.1 Judiciary and prosecution

As explained in Chapter 2 the Bailiff combines the rle of Chief Judge of the Island with being First Citizen and Speaker of the Island's Parliament. There is therefore a technical overlap between judiciary and legislature but, save for a casting vote in the event of deadlock, the Bailiff merely presides in the States and has no vote. It is the elected members of the States, led by the Presidents of the Committees, who take the political and policy decisions. The Bailiff and Deputy Bailiff are appointed by the Crown and are accountable to the Crown. They hold office during Her Majesty's Pleasure. Other Judges, known as Commissioners, may be appointed by the Bailiff.

As also noted in Section 3, the Attorney General and Solicitor General act as independent public prosecutors. They too are appointed by the Crown and are therefore accountable to the Crown. They also hold office during Her Majesty's Pleasure.

### 16.2 Obtaining and sharing evidence

The Authorities are able and willing to require information and documents for use in evidence in criminal proceedings in their own and other jurisdictions. Under the Evidence (Proceedings in other Jurisdictions) (Jersey) Order, 1983 the Royal Court can meet applications from Courts in other jurisdictions where criminal proceedings have begun and order the provision of documents or evidence for use in those proceedings. There is no restriction on the type of crime except that political offences are excluded. Under this statute, assistance can be and is given in respect of purely fiscal crimes. Indeed the Inland Revenue of the United Kingdom has commended the Island Authorities on the level of assistance they have given in several such cases where proceedings have already been launched.

The following table summarises the requests made by other jurisdictions and assistance given in recent years.

**Requests made by other jurisdictions at investigation stage and assistance given (nos. of cases per year).**

| | *1993-96 average* | | *1997* | |
|---|---|---|---|---|
| | *Requests received* | *Assistance given* | *Requests received* | *Assistance given* |
| TOTAL | 24 | 23 | 29 | 29 |

### 16.3 Extradition and swearing of evidence

The Island is covered by the Extradition Act, 1989 of the United Kingdom so that extraditions from Jersey are dealt with as extraditions from the United Kingdom. There has been one case in the last 5 years.

Warrants of arrest issued by Magistrates in the United Kingdom for offences committed in the United Kingdom can be executed in Jersey subject only to being endorsed by the Bailiff. The Island does not have any record of the number of UK warrants executed but it is a frequent occurrence and there is no known instance of the Bailiff having refused to endorse a UK warrant.

Under the Evidence (Proceedings in other Jurisdictions) (Jersey) Order, 1983 the Court may order evidence to be given on oath for use in other jurisdictions and this is frequently done.

### 16.4 Prosecutions and penalties

It is the general policy of the Authorities to prosecute cases of financial crime where there is sufficient evidence. No immunity from prosecution has been given in the last 5 years. Immunity would only be considered where it was thought necessary in the interests of justice. An example would be to obtain evidence against others more seriously involved in the crime than the person seeking immunity in return for giving evidence. The Royal Court has a strict sentencing policy for offences of breach of trust in financial crime. In the case of *Drew* in 1986 the Court said:

> *"The Full Court is going firstly to take the opportunity to restate the policy of this Court in relation to breach of trust cases. The Court has said previously, and maintained, that it is the policy of the Royal Court to impose more severe sentences than the current sentences being imposed in England ...".*

This policy has been upheld by the Jersey Court of Appeal.

In pursuance of this policy the Insular Authorities have, in the last 5 years, prosecuted the following financial advisers who have fraudulently converted funds belonging to clients:- Delaney (6 yrs' imp); Hanley (6 1/2 yrs' imp.); Hay (5 1/2 yrs' imp); Stilwell (5 yrs' imp.) In addition the Island has prosecuted Cantrade Private Bank Switzerland (CI) Limited, a wholly owned subsidiary of UBS, and two individuals (see below).

### 16.5 Restraint and confiscation powers

In cases of suspected drug and terrorism offences, the Authorities are already able and willing to trace, restrain and confiscate assets held by suspects or convicted criminals, whether based in the jurisdiction or overseas. The new All Crimes Money Laundering legislation will extend similar powers to proceeds from crimes of all kind. In the United Kingdom and most other jurisdictions the crimes covered are limited to indictable offences. Jersey does not have the concept of indictable offences and accordingly the crimes covered will be those which, if committed on the Island, would attract a maximum sentence of one year or more. This is intended by the Island Authorities to be the nearest practical equivalent to the concept of indictable offences.

The position in relation to civil proceedings is broadly the same as that in the United Kingdom. The victim of a financial crime may use the civil courts in order to obtain an injunction to freeze assets belonging to the alleged fraudster. In the event of the civil court granting judgment against the alleged fraudster, the assets can be recovered.

### 16.6 Restraint and confiscation amounts

As mentioned earlier restraint and confiscation orders can at present only be made in respect of drug and terrorism offences. No applications have yet been made in respect of terrorism offences. Where the Attorney General's Department is asked to obtain a restraint order (known in Jersey as a saisie judiciaire) it can act extremely quickly upon request because it is appreciated that funds may be removed. Orders are usually obtained within one or two days of receipt of the necessary information. The United States Ambassador to the United Kingdom recently visited Jersey to award $1 million to the Island in recognition of assistance given by the Island.

## Restraint and confiscation orders (all figures relate to drug trafficking)

| | *1993-96* | *1997* |
|---|---|---|

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | *average* | | | | | | |
| | *Nos of saisie judiciaire* | *Annual amount restrained* | *Nos of confisc. Orders* | *Annual amount confis.* | *Nos of saisie judiciaire* | *Annual amount restrained* | *Nos of confisc. Orders* | *Annual amount confis.* |
| TOTAL | 9 | 697,479 | 14 | 178,991 | 11 | 542,366 | 13 | 70,972 |

**16.7 Civil law**

It is open to the victim of any financial crime to institute proceedings against the offender and to seek recompense. For example, in the recent prosecution of the Cantrade Bank and others, the investors who have lost money have instituted civil proceedings in Jersey against the Bank seeking damages to compensate them for their loss. Such claims are regularly brought before the Royal Court and injunctive relief can be granted. In a recent case the Securities and Exchange Commission of the United States has obtained an injunction freezing certain assets in Jersey. The Court can and does order financial institutions to disclose information in civil proceedings for the purposes of tracing the proceeds of financial crime at the instance of the victim.

The Courts in Jersey regularly adjudicate on disputes arising out of finance sector activities and have, where appropriate, awarded damages against financial institutions in the Island. An example is *West v. Lazard Brothers and Co (Jersey) Limited & Others* (1993) where, after a hearing which lasted for several months and arose out of a complex set of facts, the Royal Court held that the defendants were liable for breach of trust and ordered them to compensate the plaintiff in respect of the loss caused by the breach of trust. In *Midland Bank Trust Company (Jersey) Limited & Others v. Federated Pension Services* (1995) the trustee erroneously refused to transfer the funds of a pension scheme to a new trustee until a customer agreement had been signed by the parties. Loss was caused to the trust fund during the period of delay. The Court had to consider whether this amounted to gross negligence and whether the exculpation clause in the trust deed protected the trustees from liability. In a wide ranging judgment, which was cited when a similar case later came before the English Court of Appeal, the Jersey Court of Appeal held that the trustee had committed a breach of trust and was not entitled to relief under the exculpation clause. In another recent case some investors brought an action against a firm of stockbrokers in Jersey who had advised the investors to place a substantial portion of their assets in a single bond issued by a Canadian life insurance company which subsequently became insolvent. The Court held that the advice given was negligent and ordered the stockbrokers to compensate the investors for their loss.

# 17 SOME PARTICULAR CASES

The most important recent case has been that involving Bank Cantrade. A foreign currency trader originally based in England but who moved to Jersey solicited funds for foreign currency trading. He was unsuccessful and lost approximately $11 million but falsified the results so that it appeared that he had made profits of some $15 million. The false figures were supported by a certificate signed by a partner of Touche Ross in England certifying the correctness of the valuations. The funds which were traded were placed with Bank Cantrade in Jersey and a representative of that Bank recklessly made false statements as to the performance of the foreign currency trader. The trader and the partner at Touche Ross were convicted of knowingly making false statements which induced persons to invest and the Bank pleaded guilty to recklessly making such statements. The trader was sentenced to 4 1/2 years imprisonment, the accountant to 1 1/2 years imprisonment and the Bank was fined 3 million. It was a case of considerable complexity and the trial against the two persons who pleaded not guilty took some 6 weeks. The case was complicated by the fact that Jersey law provides that prosecution for a statutory offence, which this was, must be brought within 3 years of the commission of the offence. As the Court of Appeal pointed out when dismissing the trader's appeal against sentence, a period of 4 years from initial complaint to the beginning of a trial is hardly unusual in cases of fraud and it recommended that consideration should be given as to whether the time limit of 3 years was appropriate. The Insular Authorities believe that it is clearly inappropriate for cases of fraud, which may remain undiscovered for a period of years and may then require a further lengthy period for investigation. It is intended to bring amending legislation before the States in the near future in order to remove the existing time limit.

In another case Rahman, a Lebanese settlor, established a trust in Jersey but the professional trustee company simply followed the settlor's directions during his life without having regard for its fiduciary duties. Following the settlor's death the validity of the trust was attacked. The Court held that the trust amounted to a "sham" in law and was therefore invalid because the trustee company had not acted as a trustee but only as a nominee.

An accountant in business as a sole practitioner in the provision of trust and company administration services fraudulently converted nearly 1 million of client monies to his own use. He was prosecuted, convicted and sentenced to 6 years imprisonment.

# PRINCIPAL LEGISLATION RELATING TO CRIME, MONEY LAUNDERING, FINANCIAL REGULATION, COMPANIES AND TRUSTS

## FINANCIAL CRIME AND MONEY LAUNDERING

**A. Legislation in force**

**1. Drug Trafficking Offences (Jersey) Law, 1988.**

This Law confers power upon the Royal Court to confiscate assets where a person has benefited from drug trafficking, enables the Royal Court to freeze assets where a confiscation order may be made and creates the offence of money laundering in relation to the proceeds of drug trafficking. It also enables the Bailiff to grant production orders and search warrants in connection with investigations into drug trafficking and money laundering.

**2. Drug Trafficking (Miscellaneous Provisions) (Jersey) Law, 1996.**

This Law amends the Drug Trafficking Offences (Jersey) Law, 1988 so as to incorporate the developments which have taken place in the United Kingdom in this field since 1988. In particular it enables determination of whether persons have benefited from drug trafficking for the purposes of making a confiscation order to be deferred or to be made where a person has absconded or died. It creates additional money laundering offences in relation to drug trafficking together with offences of failing to report knowledge or suspicion of drug money laundering and tipping off.

**3. Prevention of Terrorism (Jersey) Law, 1996.**

This Law enables terrorist organisations to be proscribed, enables persons to be excluded from the Island in order to prevent acts of terrorism, creates offences in relation to the proceeds of terrorist activities and providing financial assistance for terrorism and the failure to disclose knowledge or suspicion of money laundering of terrorist funds and also contains wide powers for the investigation of terrorist activities, the provision of financial assistance for terrorism and money laundering of terrorist funds.

**4. Investigation of Fraud (Jersey) Law, 1991.**

This Law enables the Attorney General to require a person to provide documents or information where a suspected offence involving serious or complex fraud has been committed, whether in Jersey or elsewhere. A search warrant may be obtained from the Bailiff where necessary. The Attorney General may disclose information or documents so obtained to any person for the purposes of a criminal investigation or prosecution outside the Island.

**5. Investigation of Fraud (Amendment) (Jersey) Law, 1997.**

This Law amends the principal Law by enabling the Attorney General to delegate certain functions under that Law and to disclose information obtained pursuant to the Law to regulatory and disciplinary bodies, whether in Jersey or elsewhere.

**6. Evidence (Proceedings in other Jurisdictions) (Jersey) Order, 1983.**

This Order extends the Evidence (Proceedings in other Jurisdictions) Act, 1975 of the United Kingdom to Jersey subject to necessary modification. It enables the Royal Court to give assistance upon the request of an overseas court where criminal proceedings have been instituted against an alleged offender before that overseas court for any offence. The Royal Court may order a person in Jersey to attend to be examined or to produce documents.

**7. Drug Offences (International Co-operation) (Jersey) Law, 1996.**

This Law makes provision for the giving of assistance in relation to criminal proceedings or investigations into drug offences. As well as allowing for service of overseas process in the Island it enables the Attorney General, where satisfied that there is an investigation or prosecution overseas in respect of a drug offence, to order that evidence be obtained in the Island for the purpose of giving effect to the request. The Law also provides for the enforcement of overseas forfeiture orders in relation to drug offences.

**8. Drug Trafficking Offences (Designated Countries and Territories)(Jersey) Regulations, 1997.**

These Regulations apply certain provisions of the Drug Trafficking Offences (Jersey) Law, 1988, as amended, to investigations and prosecutions into drug trafficking overseas. The Royal Court can make a freezing order in connection with assets in Jersey where there is a reasonable expectation of a confiscation order being made overseas which can subsequently be registered in Jersey. The Regulations also provide for the registration of an overseas confiscation order in relation to drug trafficking offences.

**9. Company Securities (Insider Dealing) (Jersey) Law, 1998**

This Law prohibits dealing on securities by insiders holding unpublished price-sensitive information and persons who obtain information from insiders. There is power to appoint investigators, grant search warrants and transmit information to prosecutors in other jurisdictions for the purpose of a criminal investigation.

**B. Future legislation in the pipeline (with anticipated year of enactment) 1. Proceeds of Crime (Jersey) Law-(1998)**

This Law will enable confiscation orders to be made in all cases of serious crime which will be defined as offences which carry a maximum sentence of one year or more. It will also constitute offences of money laundering in relation to the proceeds of serious crime and for the registration of overseas confiscation orders in relation to such offences. The draft Law is based on the equivalent United Kingdom legislation.

**2. Police and Criminal Evidence (Jersey) Law-(1999)**

This will be based upon the Police and Criminal Evidence Act of the United Kingdom. It will define and confer police powers of arrest and investigation. It will also provide for the procedures to be followed in respect of the detention of offenders. It will, in addition, amend the right of silence in the same way as has been done in the United Kingdom, introduce provisions for the disclosure of unused material and make other amendments to the law of criminal evidence so as to bring it up to date.

**3. Criminal Justice (International Co-operation) (Jersey) Law-(1999)**

This will be based upon the Criminal Justice (International Co-operation) Act, 1993 of the United Kingdom. It will make provision for the giving of assistance in relation to criminal proceedings or investigations into any offence. As well as allowing for service of overseas process in the Island it will enable the Attorney General, where satisfied that there is an

investigation or prosecution overseas in respect of an offence, to order that evidence be obtained in the Island for the purpose of giving effect to the request.

**4. Criminal Procedure (Prescription of Offences) (Jersey) Law-(1998)**

This Law will remove the time limits for the prosecution of criminal offences.

**FINANCIAL REGULATION, COMPANIES AND TRUSTS**

**A. Legislation in force**

**1. Banking Business (Jersey) Law 1991**

The Banking Business (Jersey) Law 1991 is based on the United Kingdom's Banking Act of 1987 and has two primary functions:-

- the licencing of banks to carry out deposit taking business; and
- the supervision of those banks licenced under the Law.

**2. Collective Investment Funds (Jersey) Law 1988**

The Collective Investment Funds (Jersey) Law 1988 was drawn in parts from the United Kingdom's Financial Services Act 1986.

The Law was designed to prohibit unauthorised persons from being functionaries of collective investment funds; to regulate such functionaries and funds; and for connected purposes.

**3. Insurance Business (Jersey) Law 1996**

The Insurance Business (Jersey) Law 1996 was developed in full consultation with the Insurance Directorate of HM Treasury and received their approval before being enacted.

The Law makes provision for the authorisation and supervision of insurance businesses.

**4. Companies (Jersey) Law 1991**

The Companies (Jersey) Law 1991 follows closely the United Kingdom's Companies Acts of 1985 and 1989 and replaced the Companies (Jersey) Laws 1861 to 1968.

The Law provides for the incorporation, regulation and winding up of limited liability companies. The Law was amended in 1997 to include the regulation of limited life companies.

**5. Borrowing (Control) (Jersey) Law 1947**

The Borrowing (Control) (Jersey) Law 1947 provides for the regulation of the borrowing and raising of money, the issue of securities and the circulation of offers of securities for subscription, sale or exchange.

**6. Registration Of Business Names (Jersey) Law 1956**

The Registration of Business Names (Jersey) Law 1956 provides for the registration of firms and persons carrying on business under business names.

**7. Limited Partnerships (Jersey) Law 1994**

The Limited Partnerships (Jersey) Law 1994 makes provision for the establishment, regulation and dissolution of limited partnerships.

**8. Limited Liability Partnerships (Jersey) Law 1997**

The Limited Liability Partnerships (Jersey) Law builds upon the concepts of the Limited Partnerships (Jersey) Law 1994 and on well established concepts in the USA.

The Law was designed with a view to its being used to allow the establishment of partnerships of professional persons like accountants or lawyers who will all play an active role in the partnership affairs but the partners themselves would not be liable to the full extent of their own personal assets.

**9. Trusts (Jersey) Law 1984**

The Trusts (Jersey) Law 1984 sets out the jurisdiction and powers of the Jersey Courts, matters surrounding the validity and enforceability of Jersey trusts, the duties, responsibilities and powers of trustees, liability for breach of trust, arrangements on termination of a trust, the nature of a trustee's estate and the rights of beneficiaries.

The Law was amended in 1996 to recognise purpose trusts.

**10. Company Securities (Insider Dealing) (Jersey) Law 1988**

The Company Securities (Insider Dealing) (Jersey) Law 1988 makes provision regarding insider dealing in company securities and provides for the Commission to conduct investigations on behalf of overseas authorities.

**11. Bankruptcy (Desastre) (Jersey) Law 1990**

The Bankruptcy (Desastre) (Jersey) Law 1990 was designed to amend and extend the law relating to the declaring of the property of a person to be "en desastre'; to make provision for the disqualification and personal liability of persons involved in the management of companies; to abolish certain customary law concepts; and for connected purposes.

**12. Financial Services Commission (Jersey) Law 1998**

The Financial Services Commission (Jersey) Law provides for the establishment, responsibilities and functions of the Jersey Financial Services Commission.

**13. Regulation of Undertakings and Development (Jersey) Law 1973**

The Regulation of Undertakings and Development (Jersey) Law 1973 provides that all businesses commencing in Jersey require a licence. In particular it is used to ensure that all new financial businesses meet or exceed minimum policy standards set by the Finance and Economics Committee.

**B. Future legislation in the pipeline (with anticipated year of enactment)**

**1. Investment Business (Jersey) Law-(1999)**

The draft Investment Business (Jersey) Law 199 follows closely the United Kingdom's Financial Services Act of 1986 and will provide for the supervision of stockbrokers, investment advisers and discretionary investment managers.

The primary aim of the draft Law is to further protect the interests of investors, both resident and non-resident, in their dealings with investment businesses conducted in or from Jersey.

The Law was approved by the States of Jersey in June 1998 and is presently awaiting Privy Council approval and Royal Assent.

**2. Fiduciary And Administration Business Law-(1999)**

A Law is proposed to regulate trust companies, company formation agents and administrators and custodians. A draft Law is due to be circulated by the end of 1998 and be debated during 1999.

**3. General Insurance Intermediaries Law-(2000)**

A Law is proposed to regulate general insurance brokers i.e.. those dealing with house, car and professional indemnity insurance.

# 1 SITUATION, AREA AND POPULATION

The Bailiwick of Guernsey comprises a group of islands, islets and offshore rocks situated within the Gulf of St. Malo off the north-west coast of France. The inhabited islands are as follows:

| | *Population (1996 census)* | *Area sq. miles* |
|---|---|---|
| Guernsey (including Herm, Jethou & Lihou) | 58,681 | 25.11 |
| Alderney | 2,147 | 3.07 |
| Sark (including Brecqhou) | 575 | 2.11 |
| **Entire Bailiwick** | **61,403** | **30.29** |

Guernsey's Population has grown since 1821 (when it was 20,000). The Island experienced periods of rapid population growth between 1890 and 1910 and in the 1960s and 1970s. In terms of population density there are over 2,300 persons per square mile in Guernsey, 700 per sq mile in Alderney and 273 per sq mile in Sark.

**The Island of Guernsey**


North
Vale
St Sampson
Castel
St Peter Port
St Andrew
St Saviour
St Peters
St Martin
Torteval
Forest
0
1
2
Approximate Scale (Miles)

# 2 CONSTITUTION, LAW AND JUSTICE

### 2.1 Constitutional Status

For many centuries, the Islands have been dependencies of the British Crown. However, at no time since the Norman Conquest has the evolution of the Islands' constitution involved amalgamation with, or subjection to, the government of the United Kingdom. The Islands' link with the United Kingdom and the remainder of the Commonwealth is through the Sovereign as latter day successor of the Dukes of Normandy. Under the charters of successive sovereigns the Islands have secured their own judiciaries and freedom from process of English courts and other important privileges. This remains the essence of the relationship between the Islands and the Crown to the present day.

### 2.2 Relationship with the British Crown

The Sovereign in Council exercises supreme legislative and judicial powers in the Bailiwick. The Lieutenant-Governor is Her Majesty's personal representative and the official channel of communication between the Crown and the United Kingdom authorities and the separate insular authorities.

The Crown has ultimate responsibility for the good government of the Islands. The Crown acts through the Privy Council on the recommendations of the Ministers of Her Majesty's Government in the United Kingdom in their capacity as Privy Counsellors.

### 2.3 Relationship with the United Kingdom

Her Majesty's Government is responsible for the Islands' international relations and for their defence. It is the practice for the insular authorities to be consulted before an international agreement is reached which would apply to them. The position in relation to international agreements was clarified in the report of the Royal Commission appointed in 1969 and more recently in a memorandum prepared by legal advisers in the Foreign and Commonwealth Office.

By constitutional convention Parliament does not legislate for the Bailiwick in matters of taxation and other matters which have been accepted as the responsibility and concern of the Insular Authorities. Nowadays the extension of an Act of Parliament to the Bailiwick is exceptional. It is the practice of the Bailiwick legislatures to promote legislative measures mirroring Acts of Parliament in appropriate cases.

The constitutional and economic relationship between the United Kingdom and the Bailiwick was examined by a Royal Commission appointed in 1969. It accepted the convention that the United Kingdom Parliament does not legislate on domestic matters for the Bailiwick without the consent of the Bailiwick Authorities, but nevertheless concluded that the United Kingdom must have powers in the last resort to intervene in any Bailiwick matter, including power to legislate, so long as it remains responsible for the international relations of the Bailiwick and for its good government.

The Islands are not represented in the United Kingdom Parliament. Acts of Parliament do not extend to them automatically, but only if they expressly apply to the Islands or do so by necessary implication. When it is intended that an Act of Parliament shall apply to the Islands the method that has become usual is not to apply the Act directly but to include in it a section providing for its extension to the Islands by subsequent Order in Council, with any appropriate exceptions, modifications and adaptations. This procedure permits changes to be made to meet the special needs of the Islands and to ensure that the provisions of the Act are applied in a manner consonant with the insular administrative systems and with the methods of dealing with offences in the insular courts.

Alderney and Sark both have a large measure of independence within the Bailiwick of Guernsey and have legislative assemblies of their own, the States of Alderney and the Chief Pleas of Sark. Through the Lieutenant-Governor of Guernsey each has an independent relationship with the United Kingdom.

The British Home Secretary is the Privy Counsellor primarily concerned with the affairs of the Islands and is the channel of communication between them and the Crown and the United Kingdom Government.

### 2.4 Relationship with the European Union

The Islands have a special relationship with the European Union provided by Protocol 3 to the United Kingdom's Treaty of Accession to the European Community. This relationship cannot be changed without the unanimous agreement of all the Member States of the Community.

Under Protocol 3, the Islands are part of the customs territory of the Community. The Common Customs Tariff, levies and other agricultural import measures therefore apply to trade between the Islands and non-member countries and there is free movement of goods in trade between the Islands and the Community.

However, other Community rules do not apply. Implementation of the provisions on the free movement of persons, services and capital is therefore ruled out, and, the Islands are not eligible for assistance from the structural Funds or under the support measures for agricultural markets.

### 2.5 Legislatures

| **The States of Guernsey** | |
|---|---|
| President *(Speaker)*: | The Bailiff* |
| Deputy President: | The Deputy Bailiff *<br>(* appointed by the Sovereign by Letters Patent) |
| Law Officers: | H.M. Procureur + (Attorney-General)<br>H.M. Comptroller + (Solicitor-General)<br>(+ appointed by the Sovereign by Royal Warrant) |
| (The President and Deputy President exercise a casting vote; the Law Officers have a right to speak but not to vote) | |
| 12 Conseillers# | Elected by the electors of Guernsey and Alderney for a term of six years with half retiring every third year *(Legislation has been enacted abolishing the office of Conseiller and increasing the number of People's Deputies to 45. The term of office of People's Deputies will be increased to 4 years. These reforms will take effect from the 1st May, 2000)* |
| 33 People's Deputies: | Elected by the electors of the 10 electoral districts of Guernsey for a term of 3 years |
| 10 Douzaine Representatives: | Elected by the Douzaines (Parish Councils) for a term of 1 year |
| 2 Alderney Representatives: | Elected by the States of Alderney for a term of 1 year |

| **The States of Alderney** | |
|---|---|
| President *(Speaker)*: | Elected by the electors of Alderney for a term of four years |
| 10 Members: | Elected by the electors of Alderney for a term of four years with half retiring every second year |

**The Chief Pleas of Sark**

| | |
|---|---|
| Seigneur: | Hereditary |
| Seneschal *(Speaker)*: | Appointed by the Seigneur, with the approval of the Lieutenant-Governor, for a three year term (he is not removable except at his own request or by direction of the Crown) |
| 40 Tenants: | Sit by virtue of land tenure |
| 12 Deputies of the People: | Elected by the electors of Sark (owners, either alone or jointly, of a tenement cannot vote) for a term of three years |

## 2.6 Executive

The States delegate administration to committees of members of the States and charge such committees with specific functions. Most of the Islands' public services are accordingly provided and administered by these committees of the States, in much the same way as local government services in the United Kingdom are provided and administered by committees of the local authorities. There is no ministerial system: each Committee is directly accountable to the legislature.

The States Advisory and Finance Committee is regarded as the senior committee and is mandated to examine all proposals and reports which are to be placed before the States for deliberation. The Committee is also mandated to watch over the interests of the financial services sector and to promote such legislation as is considered necessary to regulate or assist the industry and to monitor, and act as the channel of communication with, the Guernsey Financial Services Commission which is a statutory regulatory authority.

The elected States Committees are supported by a professional civil service of some 1,800 staff. Each States Committee has a Chief Officer (or Chief Executive). The States Supervisor is Head of the Guernsey Civil Service and Chief Officer of the States Advisory and Finance Committee.

The Committees also directly employ approximately 3,000 non-civil service staff, which includes manual workers (1,300), nurses (760), teachers (550), police officers (150) and customs officers (70).

## 2.7 Legal System

The judicature of Guernsey is divided into three parts namely; the Magistrate's Court, the Royal Court and the Court of Appeal. In addition there is an Ecclesiastical Court of great antiquity. In Alderney there is the Court of Alderney, and in Sark the Court of the Seneschal.

*(a) The Magistrate's Court*

The Magistrate's Court is presided over by a Magistrate or a Jurat as an Assistant Magistrate, and has summary jurisdiction in criminal matters and in civil suits where the amount claimed does not exceed 2,500.

*(b) The Royal Court*

The Royal Court administers both the civil and the criminal law in Guernsey.

The Royal Court is presided over by the Bailiff or Deputy Bailiff and comprises the Bailiff or Deputy Bailiff and twelve Jurats. The Bailiff or Deputy Bailiff, who are legally qualified, are sole judges of law in the Royal Court. The office of Jurat is of great antiquity and is somewhat similar to that of Justice of the Peace in the United Kingdom. The Jurats are elected by an electoral college comprising the Guernsey Parliament, the Jurats, the rectors and 24 additional douzeniers representing the larger parishes. There is no jury system: the Jurats fulfil a similar rle to jurors in criminal matters.

*(c) Full Court*

The Royal Court sitting as a Full Court comprises the Bailiff or Deputy Bailiff and not less than seven Jurats. The Full Court has original jurisdiction in criminal matters in respect of all indictable offences committed anywhere in the Bailiwick and other cases referred to it by the Magistrate's Court and the Courts of Alderney and Sark. The Royal Court sitting as a Full Court also has appellate jurisdiction in criminal matters where appeal lies from inferior Courts in Guernsey and from the Courts in Alderney and Sark.

*(d) Ordinary Court*

The Royal Court sitting as an Ordinary Court comprises the Bailiff or the Deputy Bailiff or a Lieutenant-Bailiff and at least two Jurats. The Ordinary Court has original jurisdiction as regards all civil suits commenced in Guernsey. There is a right of appeal to the Ordinary Court from the determination of the Magistrate's Court in most civil actions and from the Courts in Alderney and Sark. Whilst the Ordinary court has no appellate jurisdiction in criminal matters, it does have certain original jurisdiction in criminal matters relating to Alderney and Sark when it is considered that a particular offence or the punishment appropriate to it is considered to be outside its competence either by the Court of Alderney or by the Court of the Seneschal of Sark.

*(e) The Court of Appeal*

The Guernsey Court of Appeal constituted by the Court of Appeal (Guernsey) Law, 1961, has both civil and criminal jurisdiction. The Bailiff is ex-officio the President of the Court but has no involvement in appeals against his own Judgments. The other judges (called ordinary judges) are appointed by the Crown and will normally comprise eminent Queen's Counsel practising at the Bar in England and Wales, Scotland and Northern Ireland as well as the Bailiff of Jersey.

In civil matters appeals lie to the Court of Appeal from decisions of the Royal Court sitting as an Ordinary Court.

In criminal matters a person convicted on indictment or summarily convicted in the Royal Court sitting as a Full Court may appeal to the Court of Appeal against his conviction on a question of law, or fact, or of mixed law and fact; and with the leave of the Court of Appeal against the sentence passed on his conviction, unless the sentence is one fixed by law. The Magistrate's Court (Criminal Appeals) (Guernsey) Law, 1988 also provides a right of appeal in criminal cases on a point of law from the Magistrate's Court to the Court of Appeal.

In civil matters an appeal lies to Her Majesty in Council from a decision of the Court of Appeal. Where the value of the matter in dispute is less than 500 the special leave of Her Majesty in Council or the leave of the Court of Appeal is required.

In criminal matters appeals lie to Her Majesty in Council from decisions of the Court of Appeal, and nothing in the Court of Appeal (Guernsey) Law, 1961, affects the Crown's prerogative of mercy.

Any such appeals are heard by the Judicial Committee of the Privy Council which is the supreme court of appeal for the Bailiwick.

*(f) The Court of Alderney*

The Court of Alderney comprises not less than three Jurats from among the Jurats in Alderney appointed by the Home Secretary. One of the Jurats is designated by the Home Secretary as Chairman of the Court.

The Court has unlimited original jurisdiction in civil matters arising in Alderney. Judgments of the Court in civil matters are subject to a right of appeal to the Royal Court of Guernsey sitting as an Ordinary Court.

The Court has limited jurisdiction in criminal matters. There is a right of appeal in these criminal matters to the Royal Court of Guernsey sitting as a Full Court. Original jurisdiction in respect of all other criminal matters in Alderney, however, rests

with the Royal Court of Guernsey sitting as an Ordinary Court.

*(g) The Court of the Seneschal of Sark*

The Court of the Seneschal is presided over by the Seneschal.

The Court has unlimited original jurisdiction in civil matters with a right of appeal against its judgment to the Royal Court of Guernsey sitting as an Ordinary Court.

The Court has limited jurisdiction in criminal matters. There is a right of appeal in these criminal matters to the Royal Court of Guernsey sitting as a Full Court. Original jurisdiction in respect of all other criminal matters rests with the Royal Court of Guernsey sitting as an Ordinary Court. Sentences of imprisonment exceeding three days are served in Guernsey.

*(h) Criminal Law and Civil Law*

The Criminal Law and Procedure in the Bailiwick is generally similar to that of England and Wales. A defendant has the right to employ legal counsel or in the case of a Royal Court trial to have legal counsel assigned to him. When a trial is held in the Royal Court the case is heard before the Bailiff or Deputy Bailiff and at least seven Jurats. The Bailiff, as President of the Court, is the sole judge on questions of law and procedure, sums up the evidence for the Jurats and instructs them on the relevant law. The Jurats decide whether the defendant is guilty or not guilty and determine sentences, but it is the Bailiff who announces them. The verdict may be reached by a simple majority. If the Jurats return a verdict of 'not guilty' the prosecution has no right of appeal and the defendant cannot be tried again for the same offence. In the event of a 'guilty' verdict, the defendant has a right of appeal to the Court of Appeal.

The common law in the Bailiwick derives from the customary law of Normandy. However, in recent times the law in Guernsey has become more and more anglicised. Statute law is enacted in Guernsey and is mostly derived from the comparable statute law of England. The significance of the Norman customary law has declined and the English common law which is only persuasive authority is increasingly applied where the custom is irrelevant or non-existent. Nevertheless, the customary law of Normandy still has great significance in relation to the law of real property and inheritance in Guernsey. The sources of legislation in the Bailiwick are:-

(i) Laws passed by the Islands' Parliaments which obtain the Sanction of Her Majesty in Council;

(ii) Regulations and Orders made under the provisions of the Laws passed in the manner above;

(iii) Ordinances passed by the Islands' Parliaments;

(iv) Acts of the United Kingdom Parliament and statutory instruments made thereunder as extended by Order in Council with the consent of the Islands' Parliaments;

(v) Acts of the United Kingdom Parliament that are expressly applied to the Bailiwick;

(vi) Regulations of the European Community applicable under Protocol 3 - although it is normally necessary to enact local legislation to provide for penalties and enforcement;

(vii) The Sovereign, who has a right to legislate by Order in Council by the exercise of the Royal Prerogative.

Relevant judicial decisions also form a source of law in the Bailiwick. Where no clear precedent can be drawn from Bailiwick law, the Courts in the Bailiwick generally have regard to the old customary laws of Normandy and the English law when deciding the cases before them.

The Royal Court and the Court of Alderney also have power to enact Rules of Court.

**2.8 Legislation**

The Committees of the Islands' Parliaments propose the enactment of legislation in respect of matters which fall within their respective mandates. Proposals for the enactment of criminal legislation and financial services legislation are made by the States Advisory and Finance Committee generally following representations made to it by the Law Officers of the Crown or the Financial Services Commission.

Guernsey is responsible for the enactment of criminal legislation throughout the Bailiwick including Alderney and Sark. With regard to Alderney, Guernsey is also responsible for adoption, child care services, the airfield, education, health, immigration, police and social services. Guernsey income tax and impt duties are levied in Alderney.

Constitutionally, Guernsey cannot legislate for Sark or Alderney (otherwise than in the areas specified in the preceding paragraph) and legislation applicable in two or all of the Islands therefore requires the approbation of the legislatures of the Islands concerned.

Legislation is drafted by qualified draftsmen under the direction of the Law Officers. In addition to the two Law Officers there are 7 qualified legal staff and 8 supporting staff in the Law Officers' department.

The main legislation relevant to this review is listed in appendix 1.

### 2.9 Judiciary

The judiciary in the Bailiwick is independent of the Government and is not subject to direction or control by the Islands' Parliaments. The Bailiff of Guernsey is the President of both the Royal Court and the Court of Appeal but has no involvement in appeals against his own judgments. The Bailiff and his deputy are the sole judges of law in the Royal Court. The Chairman of the Court of Alderney is appointed by the Home Secretary. The Court of the Seneschal of Sark is presided over by the Seneschal who is appointed by the Seigneur with the approval of the Lieutenant-Governor.

### 2.10 Law Officers of the Crown

The two Law Officers of the Crown are appointed by the Crown. They are legal advisers to the Crown and the Islands' Parliaments. Their primary allegiance is to the Crown and so in the event of a conflict of interest they will act for the Crown and not the States of Guernsey. Both of them are debarred from private practice.

The Chambers of the Law Officers of the Crown are concerned with all aspects of the administration of justice. The Law Officers' Chambers are in effect a "Department of Justice" for the entire Bailiwick. Their duties embrace work which in England and Wales would be carried out by the Home Secretary, the Director of Public Prosecutions and the Attorney-General. They supervise prosecutions generally. In making prosecuting decisions the Law Officers act as independent officers - independent of the Islands' Parliaments and independent of the Courts before which they prosecute or in which Police Officers prosecute in their name. All prosecutions in the Bailiwick are brought in the name of the Law Officers.

They are answerable to the Crown for their actions.

The Law Officers are supported by a small specialised staff of 7 qualified lawyers, 4 of whom are Crown Advocates, and the other 3 lawyers are in course of qualifying as Advocates.

### 2.11 Conflicts of Interest

*(a) Judges, Jurats and Law Officers*

The Bailiff, Deputy Bailiff, Stipendiary Magistrate and Law Officers do not as a matter of convention retain any directorships. They and members of their family are not precluded from holding shares. They will declare any conflict of interest which may exist or appear to exist whether arising from financial interest or any other relevant interest. In appropriate cases they will decline to be involved in proceedings.

Jurats of the Royal Court may retain commercial interests. They deal with conflicts of interest in the same manner as other

members of the judiciary.

*(b) States of Guernsey*

All Members of the States, within one month of taking office, must enter on the public record a declaration of their financial interests as required by Rule 13A of the Rules of Procedure of the States of Deliberation, a publicly available document. They are also required to notify material changes within one month of the change or acquisition. The value of the interest need not be declared.

Members are obliged to declare any:

(i) trade, profession or vocation;

(ii) remunerated employment;

(iii) directorships of limited liability companies trading, or holding an interest in land, in the Bailiwick;

(iv) real property situated in the Bailiwick (other than the Member's principal residence) in which the Member, his spouse or infant children, or a company in which he has a controlling interest on his own or on their behalf;

(v) shareholdings in limited liability companies trading or holding an interest in land, in the Bailiwick, of which he or his spouse or his infant children are beneficially entitled to 10% or more of the issued share capital;

(vi) any other asset or interest held or enjoyed by the Member or any close members of his family or by any company in which he has a controlling interest which might influence his conduct as a Member of the States of Deliberation.

Where a Member has a direct or special interest in the subject matter of a proposition, he is required to declare his interest at the meeting of the States.

*(c) States of Alderney*

The President and Members of the States of Alderney are required to declare all immovable property interests and business interests in Alderney owned by themselves or their spouses. Such declarations are held in a register which is available for public inspection.

*(d) Chief Pleas of Sark*

There is no provision in Sark requiring disclosure of Members' interests.

# 3 CHAPTER 3 ECONOMY AND FINANCE INDUSTRIES

### 3.1 Economy

*(a) The Growth of the Island's Economy*

Since 1965 the Gross Domestic Product (GDP) of the Island has grown from 293m to 930m in real terms. This more than threefold increase in the wealth of the Island compares to an increase in the population of approximately 30% over the same period.

*(b) Gross Domestic Product*

Reflated Gross Domestic Product for the period 1980 to 1997

| *Year* | *Reflated GDP, m* | *GDP per head* | *Guernsey GDP as % of UK GDP per head* | *Year End Unemployment %* |
|---|---|---|---|---|
| 1980 | 596 | 11,176 | 110 | 4.0 |
| 1985 | 612 | 11,038 | 99 | 2.2 |
| 1990 | 801 | 13,601 | 114 | 0.7 |
| 1995 | 872* | 14,859 | 117 | 1.0 |
| 1997 | 930* | 15,615 | 119 | 0.5 |

(*as estimated)

GDP is calculated by the income method from locally available sources, and is made without an adjustment for bank interest. The method, which is currently under review, overstates GDP, and therefore the absolute figures quoted above should be treated with caution. Percentage changes in GDP give a better indicator of economic growth, the increase between 1996 and 1997 being 2.3%.

The high level of employment in the Island has contributed to the growth of GDP. At the end of December 1997 there were 154 persons registered as unemployed, which is 0.5% of the economically active population.

The growth in the Island's GDP was stimulated by two periods of economic growth in the Island's export industries. The first was during the 1960's and early 1970's, when substantial success was experienced in the Tourism and Horticultural Sectors of the economy. The second period of growth was in the 1980's and 1990's with the expansion of the finance sector.

By dividing GDP by the population, it is possible to derive a figure of GDP per head, showing that living standards have risen steadily since 1980, and in particular between 1985 and 1990.

*(c) The Island's Industries*

After the end of the Second World War the main industries to emerge in the Guernsey Economy were Horticulture and Tourism. The two "T's" of Tourism and Tomatoes predominated during the period 1959 to 1972.

The four main Island export industries in 1997 were Finance, Tourism, Industry and Horticulture. The relative importance of each of these industries has changed over time so that by 1997 Finance accounted for 60% of the Island's exports.

Contribution of the main sectors of the economy to GDP

| | % |
|---|---|
| Finance and related services | 60 |
| Tourism | 14 |
| Horticulture | 4 |
| Manufacturing (incl. Exported goods & services) | 9 |
| Mining | 0 |
| Other | 13 |
| TOTAL | 100 |

The percentage contribution of the Island's main industries to the economy have been calculated from a number of sources. In particular information on business profits and remuneration enable a comparison to be made between the different economic sectors.

Between 1993 and 1995 several economic impact assessments were conducted covering the Island's main export industries of Finance, Manufacturing, Tourism and Horticulture. The aim of undertaking the economic impact assessments was to seek to achieve a comparison on a like-for-like basis of the contribution of each sector of the economy.

*(d) Inflation*

The currency of Guernsey is the British pound sterling, a link which means that inflation is largely a product of UK monetary policy.

However, local inflationary forces can effect changes in the price level taking inflation above or below that of the UK. Since December 1996 inflation has been above that of the UK and as of December 1997 was 4.7% compared to 3.6% in the UK.

*(e) Public Expenditure*

The annual budgets of the Island's parliaments are balanced and the level of income is reviewed and rates of taxation revised annually if necessary (see chapter 4 on taxation). The aim is to ensure that sufficient funds are available to cover the coming year's planned revenue expenditure and appropriations for capital expenditure and to reserves.

Public Expenditure met from taxation and general revenues in 1997 was 182m or 20% of GDP.

*(f) Finance Industry*

The Island's finance industry can loosely be divided into Banks, Insurance, Investment and Fiduciaries. A number of professional institutions also exist to service the finance industry particularly in the accounting and legal professions.

Employment in Guernsey's Finance Industry

| | |
|---|---|
| Banks | 2,700 |
| Insurance | 720 |
| Investment business | 1,394 |
| Company, trust and advisory | 1,252 |
| TOTAL | 6,066 |

The above table evidences that Guernsey is a well-rounded finance sector. In addition, it should be noted that banks in Guernsey also undertake investment and fiduciary business.

**3.2 Banking - nature of business**

The types of business carried on by banks in the Bailiwick of Guernsey include:

*(a) Community banking*

This is largely provided by the United Kingdom clearing banks and covers the whole range of current account, payment transmission, overdraft, credit card, cash and personal loan products. Corporate facilities are provided to the local business community. Competitive mortgages are provided to local residents participating in the local mortgage market by the clearing banks and some other local banks.

*(b) Deposit-gatherers*

Former and current building societies operating subsidiary banks in the Bailiwick offer another range of services including:

(i) offshore deposit-gathering from expatriates;

(ii) deposit-gathering from ordinary Bailiwick and non-Bailiwick residents; and

(iii) on-lending of deposits to United Kingdom/Irish head offices to fund group mainland mortgage loan books.

*(c) International private banking*

This involves asset management, which normally utilises some form of investment management service. In general, private clients are attracted to the Bailiwick by the offer of a range of wealth generation and wealth protection products. The principal products offered to private clients are:

(i) offshore call and term deposits - these generally tap the expatriate market. Rates need to be competitive but deposits are relatively sticky;

(ii) fiduciary deposits - these typically come from Swiss clients, often introduced by intermediaries. They are placed with banks in the Bailiwick who often on-lend the proceeds into the money-markets, principally through London;

(iii) trust business - many banks offer trust services to private clients, in most cases via trust administration specialist subsidiaries. Usually this is for the purpose of inheritance planning (ie where the settlor wishes to direct his or her assets to particular beneficiaries). Company administration services are often offered side by side with

trust services. Trust business is one of Guernsey's specialisms and, although labour intensive, local staff are experienced; and

(iv) custody business - banks often offer customer and sub-custodial services to the collective investment fund administration/management business in the Bailiwick. This often generates spin-off business in foreign exchange and other transmission business when portfolios are traded.

Other products offered by the international private banks include discretionary cash management; various types of lending (such as leveraged portfolio lending, international property lending, local mortgage lending and specialist lending in connection with, for example, yacht finance and Corporation of Lloyd's guarantees); and foreign exchange trading.

### 3.3 Banking - reasons for business

The reason for banks choosing to establish operations in Guernsey is almost always client led. Many customers demand that their bank offers an offshore alternative for a variety of reasons. These reasons include:

(i) a perception that their money is managed in a small jurisdiction outside the "superstate" of the European Union;

(ii) a desire to keep assets offshore whilst working or living outside their usual place of domicile;

(iii) wealth protection and planning offered by a jurisdiction that recognizes the common law based trust concept;

(iv) a wish to keep their affairs private (in contrast to the European Union environment where the State is perceived by some to be all-pervasive);

(v) the belief that the quality of service provided is high and that the range of products available is wide; and

(vi) tax planning.

Guernsey is chosen over many other offshore and onshore centres for the following reasons:

(i) the client is choosing a bank which happens to be in Guernsey;

(ii) political stability;

(iii) fiscal independence;

(iv) international supervisory and regulatory standards;

(v) open relationship between finance sector and the authorities;

(vi) wide range and quality of professional support services;

(vii) low taxation;

(viii) good communications;

(ix) convenient time zone;

(x) competitive administrative costs;

(xi) mature and wide-ranging commercial infrastructure;

(xii) no exchange controls; and

(xiii) no capital gains tax.

### 3.4 Banking - magnitudes and geographical distribution of business

*(a) Assets and liabilities*

Bank liabilities and assets at 31 March 1998 were broken down as follows:

| | *LIABILITIES* *(bn)* | *ASSETS* *(bn)* |
|---|---|---|
| Guernsey | 14.3 | 3.1 |
| Jersey | 1.2 | 1.8 |
| Isle of Man | 0.4 | 0.0 |
| United Kingdom | 7.8 | 21.9 |
| Rest of the World | 29.9 | 26.8 |
| TOTAL | 53.6 | 53.6 |

There are banks from 20 jurisdictions based in the Bailiwick. Deposits as at 31 December 1997 were split by currency as follows:

| | | |
|---|---|---|
| US$ | : | 45.7% |
| | : | 33.9% |
| DEM | : | 10.7% |
| SWFr | : | 3.4% |
| Others | : | 6.3% |

*(b) Geographical spread of customers*

Generally, Guernsey's banking sector relies much less on United Kingdom source business than it did 10-15 years ago. Business now tends to be sourced from all around the world including continental Europe (not just the European Union), East and Southern Africa, the Middle and Far East, Latin America and (a little) from North America. Very little (if any) business comes from former Soviet Union countries. The source of business is a standard agenda item when meetings are held by the Guernsey Financial Services Commission ("the Commission") with banks in the Bailiwick.

*(c) Categories of customer*

Categories of customers are varied and can range from the expatriate community, small and large personal investors and Guernsey resident current account holders to large multinational corporations or banks. Generally, outside the clearing banks, individual deposit size is high.

*(d) Outward investment and business flows*

There is a net flow of deposits from Guernsey to the United Kingdom usually in the region of 10-15 billion but sometimes more. For example, as at the end of April 1998 8.1 billion of deposits were placed in the Bailiwick from the United Kingdom. This compares with 19.6 billion of deposits placed by Guernsey banks into the London money-market (where United Kingdom banks earn interest rate margins). There was a net flow into Guernsey from the "Rest of the

World" (ie excluding the United Kingdom, Guernsey, Jersey and the Isle of Man) of 9.8 billion.

*(e) Banks: number, quality, subsidiaries and branches*

As at 1 May 1998 there were 76 licensed banks, all of international standing and good repute. All Guernsey banks are part of a wider banking group, all of which operate as banks or building societies elsewhere. There are no indigenously owned Guernsey banks. There are 52 subsidiary operations in Guernsey and 24 branches.

*(f) Administered banks*

Guernsey operates two types of bank, namely the stand-alone banks and the administered banks. There were 29 administered banks and 47 stand-alone banks as at 31 May 1998. The administered bank concept was introduced by the Commission in the late 1980s and enables deposit-takers to conduct activities in the Bailiwick in a resource efficient manner. An administered bank uses the services and facilities of an administering bank which is itself established in the Bailiwick and has its own business there. However, the administering bank provides support and processing staff together with infrastructure and, sometimes, systems to enable an administered bank to function. The primary books and records of the administered bank must be retained in Guernsey and the administering banks probably provide one or two local directors (in the case of subsidiaries). These are complemented by directors from the parent bank and non-executives (either local or non-local). In some cases, Guernsey has hybrid versions of the administered bank concept - these employ some of their own staff (either from head office or recruited locally) as well as using some of the support staff and facilities provided by the local administering bank.

Administered banks are licensed and supervised in the same manner as stand-alone banks. No distinction is made in the type of licence issued or in the rigour of banking supervision exercised. There are no categories of banking licence in Guernsey.

*(g) Other deposit-takers*

In essence, banks are the only deposit-takers in Guernsey. A person taking deposits by way of business requires to be licensed as a bank under the Banking Supervision (Bailiwick of Guernsey) Law, 1994 ("BSL"). However, paragraph 4 of the Banking Supervision (Bailiwick of Guernsey) Regulations, 1994 exempts the Channel Islands Co-operative Society Limited from the need for a licence to accept deposits from members of the Society so long as no member has share capital and loans together of no more than 20,000. The Society is permitted to publish advertisements but only to its members. Other exempt persons, as outlined in the BSL include:

(i) the States of Guernsey; States of Alderney; and Chief Pleas of Sark;

(ii) a central bank of a member state of the Organisation for Economic Co-operation and Development;

(iii) the United Kingdom's National Savings Bank;

(iv) a friendly society carrying out transactions permitted by the rules of the society; and

(v) registered or exempt insurers carrying out insurance business.

### 3.5 Bureaux de change

There are 15 bureaux de change operating within the Bailiwick, eight in the island of Guernsey, four in Alderney and three in Sark. Nine bureaux de change are operated by clearing banks and six by other parties.

It is extremely rare for a bureau de change transaction to involve a sum of more than 4,000 (less than 1% of transactions) and virtually all such transactions originate from institutions (financial or otherwise) within Guernsey. Five bureaux contacted by the Commission confirmed that standard "know your customer" procedures are operated for any sum above what appears to be holiday requirements.

### 3.6 Investment business - nature of business

The types of investment business carried on in the Bailiwick include:

(i) management, administration and custody of collective investment funds (open and closed-ended);

(ii) discretionary asset management;

(iii) non-discretionary asset management;

(iv) stockbroking; and

(v) provision of investment advice.

### 3.7 Investment business - reasons for business

Please see the subsection 3.3 entitled "Banking - reasons for business" above, which applies equally to investment business.

### 3.8 Investment business - magnitudes and geographical distribution of business

No specific data is available in respect of individually managed discretionary and non-discretionary portfolios.

So far as collective investment funds are concerned, the total assets (and therefore total liabilities) of collective investment funds at 31 March 1998 were:

| | | |
|---|---|---|
| Open-ended | 11.6 bn | |
| | | (Class A 3.3 bn, Class B 8.3 bn) |
| Closed-ended | 5.1 bn | |
| | 16.7 bn | |

*Estimated geographical distribution of collective investment fund assets at 31 March 1998*

| | |
|---|---|
| Asia | 9% |
| Europe, excluding United Kingdom | 18% |
| Global | 26% |
| Latin America | 1% |
| North America | 11% |
| Other (eg single country schemes) | 24% |
| United Kingdom | 11% |
| | 100% |

No data is available for the residence of the 128,989 registered holders of shares/units/ partnership interests in the 517 classes of open-ended schemes and the 197 closed-ended schemes. The fact that these schemes are sponsored by institutions based in 38 countries would suggest a wide international range of investors. In this connection, it is interesting to note that a survey of Class A open-ended schemes (funds which are recognized under the United Kingdom Financial Services Act 1986 and therefore eligible for marketing to the general public in the United Kingdom) revealed that, at 31 December 1997, the average percentage of United Kingdom investors in these funds was 44% by net asset value.

Clients of investment businesses include local residents, overseas residents and local and overseas institutions and professional firms. Given Guernsey's reputation as an international finance centre, the geographical spread of clients is undoubtedly diverse. In the collective investment fund sector, although the retail element is important (comprising some 30% of the open-ended sector by value), the trend over the past five years has been towards establishing funds for high net worth individuals and institutions. Classes of funds are available in an equally wide range of international currencies.

There are currently 196 institutions licensed to carry on investment business, of which some 170 are companies incorporated in Guernsey, one is a Guernsey partnership and 25 are branches of international institutions. The Commission's policy is to license only quality institutions. Much weight is given to the status and reputation of applicants for licences and only those of the first rank are encouraged. A demonstrable and favourable track record in an established jurisdiction is a normal pre-requisite and authorisation by an overseas regulatory authority is not, in itself, generally sufficient.

In addition to administrators/managers and custodians/trustees of collective investment funds, licensees also comprise stockbrokers, discretionary and non-discretionary investment managers and investment advisers.

### 3.9 Insurance - nature of business

Insurance business in Guernsey can be analysed into two distinct sectors: domestic and offshore.

*(a) Domestic insurance business*

There are five local insurers writing domestic insurance business in Guernsey. Three are mutuals which were established in the 19th century. The other two insurers do not write exclusively domestic business but may act as rent-a-captives (a rent-a-captive provides capital and captive facilities to a third party) and accept retrocessions from Guernsey captives and captives domiciled in other areas. All five local insurers are registered under the Insurance Business (Guernsey) Law, 1986, as amended ("IBL").

In addition to the above locally organized category there are more than 140 insurers with a presence in Guernsey which are incorporated and authorised to write business within a Member State of the European Union or they are recognized friendly societies. These insurers may have a physical presence in Guernsey owing to the existence of a branch office or through the presence of insurance agents resident in Guernsey, or they may be approached in their jurisdiction (mainly the United Kingdom) by a local insurance broker or by prospective or current policyholders. These categories of insurer are currently exempt from registration under the IBL. Recent changes to the IBL have resulted in this exemption being withdrawn (see chapter 8 for further information).

*(b) Offshore insurance business*

Offshore insurance in Guernsey can be categorised as either captive and commercial insurance, (including protected cell companies), offshore life and pensions or offshore intermediaries (see chapter 8 for further information).

*(c) Captive and commercial insurance*

Guernsey is the major European captive insurance centre. The primary purpose of a captive is to insure the exposures of the parent company and its subsidiaries. Such captives are known as pure captives and these account for the majority of Guernsey's captive market. Captive insurance companies have been in existence for over 200 years. Major insurance buyers

formed their own insurance companies because they could not obtain adequate insurance cover at the right price - or even at all in some cases. The first known captive in Guernsey was formed in 1922.

Captives originally set up to insure the risks of their parent company sometimes find themselves with a wealth of specialist insurance and risk management knowledge within their own industries and offer these facilities to third parties. After moving from a pure captive to a broad captive they occasionally write much more third party business than that of their parents and are then true commercial insurers.

Reinsurers have recognized that captives have tended to be formed by insurance buyers with low claims experience (they needed to be to have expectation of profit) and a specialist market has developed to meet the needs of such captives.

Protected cell companies extend the benefits of captive insurance to small companies and organisations. Previously, only medium to large companies and organisations usually found it financially viable to set up a captive. The introduction of protected cell company legislation in 1997 has laid the foundation for, and was mainly introduced to facilitate, Guernsey's rent-a-captive business. Protected cell companies allow the insurance business of each different insurer to be written into different cells where the assets of one cell are protected by law from the liabilities of the other. They are of particular interest to the promoters of association captives, composite captives involving both life and general insurers, international groups involving numerous autonomous subsidiaries and even insurers who wish to separate the life funds of different policyholders into separate cells (or classes) within a protected cell company.

*(d) Offshore life and pensions*

There are a number of offshore life and employee benefits insurers operating in Guernsey.

Offshore life and employee benefits insurers provide insurance for non-residents. These include United Kingdom and other expatriate workers in overseas territories, many of them on short-term assignments which means that their careers may embrace employment in several overseas countries.

A mobile employee has the potential to be subject to the tax rgime of every employment location and may face having to carry small pensions from a number of locations. Therefore, these employees and others working overseas need their life and employee benefits cover to be flexible and innovative, and placed in a tax neutral location with high security and the availability of high quality collective investment funds. Guernsey meets these needs and a number of major insurance companies have located subsidiary or branch operations in Guernsey to serve these specialist markets.

The main products offered in Guernsey include pensions, group life and other group employee benefit plans for companies and life and single premium and other portfolio bonds. Overall, these products provide employees and others with a combination of security, transferability and favourable investment and tax rgimes.

The different pensions products available in Guernsey can be categorised as follows:

(i) domestic personal pensions;

(ii) international personal pensions;

(iii) domestic occupational pension schemes;

(iv) international occupational pension schemes; and

(v) retirement annuity trust schemes (RATS).

*(e) Offshore intermediaries*

There is also a separate category of Guernsey intermediary - those institutions which may be owned by overseas nationals and place business in other territories apart from their own or Guernsey. This type of company is required to register with the Commission under the recent changes to the IBL.

**3.10 Insurance - reasons for business**

The main reasons for establishing insurance operations in Guernsey are the efficiency and the knowledgeable, hands-on, pro-active and firm nature of the supervisory process. Other important reasons include: financial considerations; the use of an independent territory to manage global programmes; the quality and competitiveness of Guernsey's insurance management; and the easy accessibility to major insurance centres such as London.

Guernsey has developed new insurance and, especially, reinsurance that is shared with the United Kingdom and other onshore markets and which has become conventional business

in these markets. This process is widely recognized and has made Guernsey a desirable location for insurers. As a major offshore insurance location Guernsey has specialist captive and other insurance management companies which have been established to provide services to offshore insurance company owners. The specialist knowledge and expertise developed by Guernsey insurance managers can provide a high level of service for complex and innovative products. Due to the number and diversity of captives Guernsey plays an important part in facilitating a high level of innovation, thus helping the development of new forms of insurance.

The economies of scale arising from managing a number of insurers has meant that offshore insurers can operate more economically with specialist management than if the parent company were to self-manage the captive. In most cases, operating costs are at a low level compared with operations onshore. For a captive insurance company this is a very important advantage to the new owner with no experience of in-house insurance management, as it provides economic management. There is, as yet, no significant onshore parallel to the quality and cost-effectiveness of offshore insurance management in major centres such as Guernsey.

Guernsey has received substantial endorsement from the standing and quality of the owners of many of its insurance companies which include a number of publicly owned bodies in the United Kingdom and overseas.

Other reasons identified by the Commission for insurers locating in Guernsey include:

(i) confidentiality;

(ii) financial strength - Guernsey's offshore captive insurance companies have traditionally helped to create strong insurance and solvency ratios which are typically more than twice the onshore average. This is a major contributing factor in there being only one insurer failure in Guernsey - a record which is difficult to match onshore;

(iii) critical mass of a mature and widely developed centre;

(iv) good communications;

(v) the high quality of institutions established in Guernsey and the international reputation of the Commission; and

(vi) cost-effectiveness and competitive pricing.

**3.11 Insurance - magnitudes and geographical distribution of business**

*(a) Categories of insurers*

There are four categories of insurers operating in Guernsey. The split between the four categories at 30 April 1998 was as follows (the numbers are shown in brackets):

(i) offshore (347) - including both captive insurers and other offshore insurers;

(ii) a. domestic overseas (128) - insurance companies licensed in a European Union country;

b. domestic overseas (10) - other overseas (non-European Union) companies registered to write Guernsey domestic business -typically life insurers based in other offshore locations selling life insurance to Guernsey citizens; and

c. domestic local (5) - local insurers writing Guernsey and other business including three long-established Guernsey mutuals.

In 1996, premium income for Guernsey insurers exceeded 1.94 billion with year-end assets of 6.5 billion.

In Guernsey, specialist insurance management companies owned or associated with international insurers, brokers or consultants, together with independents, manage most of the offshore insurers. The Commission requires such insurance managers to be authorised and, at the end of 1997, 37 were authorised, 33 having an unrestricted licence and the other four being limited to the management of specified companies.

*(b) Market growth 1991 - 1996*

| million | | | | | | | *Growth %* |
|---|---|---|---|---|---|---|---|
| | *1991* | *1992* | *1993* | *1994* | *1995* | *1996* | *1991-6* |
| Gross premium | 627 | 700 | 922 | 1259 | 1370 | 1940 | 209 |
| Reinsurance | 164 | 188 | 196 | 226 | 224 | 324 | 98 |
| Net premiums | 463 | 512 | 726 | 1033 | 1146 | 1616 | 249 |
| Total assets | 1420 | 1860 | 3450 | 4265 | 4784 | 6457 | 355 |
| Of which: | | | | | | | |
| Bank deposits | 509 | 616 | 888 | 920 | 1220 | 1272 | 150 |
| Investments | 670 | 980 | 1840 | 2283 | 2337 | 4433 | 562 |
| Other | 241 | 264 | 722 | 1062 | 1227 | 752 | 212 |

*(c) Geographical distribution 1996*

*million*

| | *United Kingdom* | *Europe* | *North America* | *Africa* | *Other* |
|---|---|---|---|---|---|
| Gross premiums | 1379 | 287 | 47 | 152 | 76 |
| Reinsurance | 207 | 93 | 8 | 4 | 13 |
| Net premiums | 1172 | 194 | 39 | 148 | 63 |
| Share % | 72.5 | 12.0 | 2.4 | 9.2 | 3.9 |
| Total assets | 4681 | 775 | 155 | 594 | 252 |
| Of which: | | | | | |
| Bank deposits | 1073 | 113 | 31 | 6 | 50 |
| Investments | 3214 | 532 | 106 | 408 | 173 |
| Other | 394 | 130 | 18 | 180 | 29 |

*(d) Geographical diversification of captive insurance business at 30 April 1998*

| *PARENT COMPANY ORIGIN* | |
|---|---|
| *Country* | *Number* |
| United Kingdom | 267 |
| Other Europe | 42 |
| Rest of World | 18 |
| South Africa | 14 |
| North America | 6 |
| TOTAL | 347 |

The portfolio of captive insurance business has been diversifying in recent years with only 40% of the 1997 registrations being of United Kingdom origin. This trend of diversification looks set to continue.

**3.12 Stock Exchange**

The Channel Islands Stock Exchange ("CISX") is a new stock exchange which is expected to commence operations in the autumn of 1998. The CISX has been created primarily to provide trading and listing facilities for collective investment funds, debt instruments and shares in companies.

The CISX has been formed as a company limited both by guarantee and by shares. Its ownership will be in the hands of its members, while the management and control will be vested in the Board which is to be elected largely on a constituency basis. Based in St Peter Port in Guernsey, the CISX will offer a listing facility and provide screen-based trading.

Initially, the CISX will concentrate on its core products which are:

(i) investment funds;

(ii) structured debt instruments;

(iii) primary and secondary listings of securities and shares issued by Channel Islands companies; and

(iv) secondary listings of securities and shares issued by overseas companies.

It is anticipated that the CISX will bring international prestige and economic benefit to the Channel Islands. The principal benefits derived from the CISX will be to broaden the scope of the financial services offered in the Channel Islands and increase the competitiveness of the industry by offering a "one-stop shop" for financial services.

**3.13 Trust and company business -nature of business**

Fiduciary services have been provided in the Bailiwick for many years. The first mention of a trust in Guernsey statute law occurred in 1840 when provisions for certain types of very restricted trust were incorporated in the inheritance laws.

Fiduciary services principally relate to trust management, company management and, to a lesser degree, the provision of executorship services.

*(a) Trusts*

Of the islands which comprise the Bailiwick only the island of Guernsey possesses its own trust law. However, this does not mean that fiduciaries within the Bailiwick only administer trusts which are subject to Guernsey law; fiduciary firms have developed a great deal of experience in administering trusts subject to the laws of a number of jurisdictions.

Guernsey trusts can be tailored to almost any individual client situation, the most common form being the private discretionary trust accompanied by a letter of wishes from the settlor which can be updated from time to time as circumstances change. The extension to Guernsey in 1993 of the Hague Convention on the recognition of foreign trusts has given further impetus to the expansion of trust services in Guernsey. Under the Convention any jurisdiction which ratifies the Convention must recognize trusts which have been established under the laws of jurisdictions which have ratified the Convention.

Besides their private use in family situations, increasing use has been made of trusts as investment vehicles (collective investment funds) and for company pension schemes.

The reasons for which trusts are created in Guernsey are various but many would be for the following:

(i) wealth protection;

(ii) easing the administration of assets upon death;

(iii) avoiding potential disputes amongst heirs;

(iv) for traditional trust reasons, eg the protection of a spendthrift child;

(v) to preserve confidentiality and privacy;

(vi) to facilitate retirement pension schemes;

(vii) collective investment funds; and

(viii) establishment in a "safe" jurisdiction at a time of economic or political instability in a settlor's home country.

As the development of trust services in the island of Guernsey became more rapid, and in order to clarify the precise way in which the Court might deal with certain trust matters, the Trusts (Guernsey) Law was enacted in 1989 with a subsequent amendment in 1990 (together "the Trusts Law").

The Trusts Law imposes stringent standards of conduct on trustees. Trustees in Guernsey must at all times observe the utmost good faith and act impartially (unless the deed provides otherwise) and strictly in accordance with the terms of the trust. They are not permitted to benefit personally except to the extent permitted by the trust, eg the payment of trustees' fees, and must act at all times to a standard known as "en bon pre de famille" which is a phrase particular to Guernsey law meaning that a trustee must in all cases act as a good father would act towards his children.

Trustees can be removed from office by the Court. A trustee who commits or concurs in a breach of trust is liable for any loss or depreciation in value of the trust assets resulting from the breach.

Where a breach of trust is committed by a corporate trustee which:

(i) is a trustee of a Guernsey trust;

(ii) is resident in the island of Guernsey; or

(iii) is carrying on business in the island of Guernsey or from an address in the Island

every person who at the time of the breach was a director of the trustee is deemed to be a guarantor of the trustee in respect of any damages and costs awarded by the Court against the trustee in respect of the breach. However, the Court can relieve trustees of personal liability in respect of a breach of trust where particular circumstances justify the granting of such relief. Trusts may be revocable or irrevocable and the governing law of the trust may be changed to the law of another jurisdiction. There is a duty to keep trust accounts and (unless the terms of the trust remove the obligation), the trustee must give

information to the beneficiaries.

*(b) Companies*

The island of Guernsey has its own distinct company legislation. The existing company laws dating from 1908 were consolidated into the Companies (Guernsey) Law, 1994. In addition, since 1994 a number of additional laws and ordinances have been added to the 1994 legislation.

Alderney also has its own distinct company law, the Companies (Alderney) Law, 1994.

Sark does not possess its own company legislation.

The different forms of companies operating or registered in Guernsey are:

(i) companies limited by shares;

(ii) companies limited by guarantee;

(iii) companies limited by shares and guarantee; and

(iv) protected cell companies.

Several thousand companies are administered in the Bailiwick by fiduciaries who provide the directors and officers as well as secretarial and accounting services to assist clients in the management of their corporate affairs. Clients find many uses for companies in Guernsey and Alderney, including the following:

(i) as a vehicle for holding all types of investments including real estate, stock exchange investments and intellectual property;

(ii) as a vehicle for trading internationally;

(iii) for world-wide financial reasons; and

(iv) as a means of simplifying transmission on the death of the beneficial owners which can prove cumbersome, especially if more than one jurisdiction is involved.

With the exception of 11 companies limited by guarantee (or by guarantee and shares) all companies incorporated in the Bailiwick are companies limited by shares. There is no distinction between private and public companies. This does not preclude shares in a company from being offered for subscription to the public and quoted on a stock exchange, subject to the consent of the Guernsey authorities.

A Bailiwick company can be an income tax company, an "exempt" company or an international company ("IC"). ICs are known in other jurisdictions as international business companies.

An income tax company (also known as a resident company) pays 20% income tax on its annual taxable profits. Such companies are deemed to be resident in the Bailiwick for tax purposes if they are either:

(i) controlled in the Bailiwick (meaning, broadly, shareholder control); or

(ii) incorporated in the Bailiwick and have not been granted tax exempt status.

An "exempt" company, which operates internationally, which is not owned by Bailiwick residents and which does not trade in the Bailiwick, may apply for exempt status and pay an annual exemption fee of 600 with no further tax payable locally on their profits. Exempt companies are generally used to hold assets or investment portfolios or intellectual property rights such as trademarks, patents and copyrights. Directors of exempt companies may be Bailiwick residents and Board meetings may be held in the Bailiwick.

International companies are a specified category of resident company and were introduced as a form of company in

Guernsey in 1993. An IC has the choice of paying an agreed rate of tax ranging from something more than zero up to a maximum of 30%, depending upon the parent company's need to optimise its global tax position. An IC must be beneficially owned outside the Bailiwick and must not derive any of its trading income from within the Bailiwick. The tax rate for an individual IC may be set for up to a maximum term of five years. An international company that does not renew its status will subsequently be liable to tax at the standard rate of 20%. Banks, certain insurers and companies which have been regarded as resident or tax exempt under the Income Tax (Guernsey) Law, 1975 are not permitted to be ICs. IC status is only available to new operations, ie existing companies are not permitted to convert into ICs.

The incorporation of a Bailiwick company can usually be completed in a few days. All company applications must be submitted by a local Advocate and consent to form a company is at all times required from the Commission acting on behalf of the States Advisory and Finance Committee. The Commission requires disclosure to it on a confidential basis of beneficial ownership and the reasons for incorporation to see that

neither the individuals nor the activities of the company will bring disrepute to the Islands. All applications are also submitted to the Law Officers of the Crown for their approval. Guernsey is one of the very few jurisdictions in the world with these requirements. If permission is given, the company can then be registered by the Greffe (Registry).

Shares may be issued in any currency and of any fixed nominal value, the most common choice being sterling. Bearer shares are not permitted. Shares may be of different classes, eg ordinary or preference with different voting, dividend or other rights. There are no restrictions as to the nationality or the residence of shareholders.

A Bailiwick company must have its registered office in the Bailiwick where the register of shareholders and directors and minute books must be kept.

Each January a return has to be filed detailing the names of the shareholders appearing on the register together with the names and addresses of the directors. The return must be accompanied by the payment of document duty of 100. Both the register and annual return are available for public scrutiny but there is no requirement to disclose to the public who is behind nominee shareholders. Shares are freely transferable unless the Articles of Association provide to the contrary and there is no stamp duty payable on share transfers. Every company must hold an annual general meeting of its shareholders who may be represented by proxy. General meetings may be held anywhere in the world.

A Bailiwick company is managed by its Board of directors and minutes of all directors' meetings must be kept. None of the directors or officers of the company need be resident in the Bailiwick. The names and addresses of the directors in office at 1 January each year must be included in the annual return mentioned above. Meetings of directors may take place in the Bailiwick or outside the jurisdiction.

Every company must keep accounting records. In addition, every company is required to have its annual financial statements audited except for dormant or asset holding companies with ten or less members, which can elect to dispense with an audit. There is no legal requirement to publish annual financial statements.

*(c) Wills and executor services*

A minor part of the fiduciary sector is the provision of executorship services.

The necessity of making a valid will to deal with the assets of the individual on death is very important and without such a document the estate will fall to be dealt with according to the intestacy laws of the country of domicile of the deceased. These laws may provide for the disposal of the assets in a manner totally different to the true wishes of the deceased.

Many fiduciary businesses in the Bailiwick offer a specialised service for acting as executor of wills dealing with the estate of both resident and non-resident clients.

Upon the death of the client the executor applies for Grant of Probate, which is issued by the Ecclesiastical Court of the Bailiwick. Wills relating to real estate situated in Guernsey are dealt with by the Royal Court.

*(d) Who provides the fiduciary services?*

The firms providing fiduciary services in the Bailiwick are varied and range from the bank-owned trust companies through to accounting and law firms and a number of independently owned private trust companies. There are approximately 130 fiduciary firms providing a variety of services in the Bailiwick and estimates are that they currently administer assets of some 50 billion. Upwards of 1,000 staff are involved directly in this area of the finance sector.

**3.14 Trust and company business -reasons for business**

The reasons for establishing companies and trusts in Guernsey include the following:

(i) political stability (no political parties);

(ii) recognized technical experts with international accountancy firms and lawyers providing first-class support services;

(iii) wide-ranging banking, investment and insurance facilities;

(iv) confidentiality;

(v) no exchange controls;

(vi) favourable cost and flexible tax structure - no value added tax;

(vii) good communications by air and sea;

(viii) good postal and telecommunications services and the latest computer technology;

(ix) recognition of Guernsey trusts under the Hague Convention; and

(x) ability to tailor Guernsey trusts to almost any client situation.

**3.15 Trust and company business -magnitudes and size of business**

As is the norm world-wide, there is no register of trusts and there are no current figures available on the number of trusts established or administered from Guernsey. It is therefore not possible to estimate accurately the current amount of assets held in them or to give an accurate geographical spread of the settlors or beneficiaries. However, following an economic benefit survey in 1996 (covering a selection of the main financial institutions) which included information on clients' assets under management as at 31 December 1995, the following results were obtained:

**FIGURES FOR SELECTED INSTITUTIONS THE VALUE OF ASSETS**

| | *bn* |
|---|---|
| The total value of assets held by trusts | 16.8 |
| of which for account of United Kingdom clients | 4.5 |
| The total value of assets owned by companies | 12.7 |
| of which for account of United Kingdom clients | 2.4 |
| The total value of assets owned by individuals | 6.0 |
| of which for account of United Kingdom clients | 0.4 |
| **TOTAL VALUE OF ASSETS** | 35.5 |
| of which for account of United Kingdom clients | 7.4 |

**THE NUMBER OF ACCOUNTS**

| | |
|---|---|
| The number of trusts administered | 25819 |
| of which for account of United Kingdom clients | 8978 |
| The number of companies administered | 18194 |
| of which for account of United Kingdom clients | 3578 |

# 4 TAXATION

### 4.1 Policies

The Islands' Parliaments value their independence and recognise that self-sufficiency is fundamental in preserving this and consequently follow cautious and prudent financial policies combined with a rgime of good housekeeping.

It is a general principle that annual budgets should be balanced. Thus, the level of income is reviewed and rates of taxation revised annually with the aim of ensuring that sufficient funds are available to cover the coming year's planned revenue expenditure and appropriations to reserves and for capital expenditure.

There is a general presumption against borrowing to fund capital or revenue expenditure. If there is a shortfall in projected income and it is not considered appropriate to increase taxation or reduce revenue expenditure to restore the deficit, capital expenditure is reduced. This policy has meant that while the States may not be able to embark on certain public works, no additional tax has had to be levied to fund interest and capital repayments. Instead, the States endeavour to accumulate capital funding in advance of need, thereby increasing interest income which minimises the burden on taxpayers.

In principle, borrowing might be considered to fund capital expenditure where the project concerned was on a very large scale and would bring long term direct benefits to States finances. However, in practice the policies of the Islands' Parliaments have meant that this has not been the case.

Borrowing is sometimes undertaken by the publicly owned utilities which are self-accounting and self-funding entities.

### 4.2 Indirect taxation

Indirect taxes are raised primarily as follows:

(a) on imports and locally produced alcohol, tobacco and motor spirit on non EU imports

(b) document duty on transactions involving real property, registration of bonds, share capital and annual returns of companies

(c) automobile tax

(d) on rateable values of properties

The rates of taxes are generally (but not in all cases) lower than similar taxes in the UK. Rates of duty on non-EU goods are the same as in the UK. However, revenue from non-EU imports are minimal in most years since the bulk of non-EU origin goods consumed in the Islands are imported via the UK which therefore collects and benefits from the duties.

Crown Revenues amount to about 4m, the majority of which relate to a duty on transfers of real property in Guernsey (together with document duty, taxes on transfers of real property over 130,000 amount to 3.5% on the value of the transaction). Crown Revenues may therefore be regarded as an indirect tax.

In total, indirect taxes are estimated to raise about 31m in 1998 (15% of income). The product of taxation is allocated for use across the whole range of States activities and no portion is earmarked for use in the area from which it is raised.

Services and benefits under the Social Insurance and Health Service Schemes are funded by contributions from employees, employers, the self-employed and non employed and also from general taxation.

The basic contribution rates for employees and employers are 4.5% and 5.4% of earnings respectively. Contributions are capped for both employee and employer based on an upper earnings limit of 459 per week. Notwithstanding the relatively modest level of contributions, benefits are generally higher than in the UK and are paid through Scheme Funds which amount to several years' benefit expenditure.

### 4.3 Direct taxation

Direct taxation has never been levied on capital gains, inherited assets or other transfers of assets (with the exception of a 100% tax on the profits of dwellings held for less than a specified period. The "Dwellings Profit Tax" is an anti-speculation tax).

The major proportion of general revenue income (about 76%-153 million out of estimated total income of 202 million in 1998) is raised through income tax on both the incomes of individuals and corporate trading profits. (There is no separate corporation tax). The standard rate of income tax has remained at 20% since 1960 prior to which the rate varied around the 25% level. Surtax existed at various rates from 1940 until it was abolished in 1955.

International companies, which are owned by non residents, are resident for income tax purposes but they are taxed on a different basis. So long as the company does not trade with Guernsey residents it may pay a varying rate of tax. For more information about international companies see chapter 3.

### 4.4 Taxation of non-residents

The liability of a non-resident is determined in accordance with the provisions of section 5 of the Income Tax Law ("charge of tax and liability to tax according to residence").

An individual or company not resident in Guernsey is liable to tax on his or its income derived from:

(a) businesses carried on in Guernsey;

(b) offices or employments held or exercised in Guernsey;

(c) Guernsey land and buildings;

(d) any other source in Guernsey, except that

(1) deposit interest from Guernsey banks and other deposit taking institutions; and

(2) income derived from approved tax exempt collective investment schemes are not subject to Guernsey Income Tax.

Exempt companies which have no Guernsey business nor any other source of Guernsey income (other than deposit interest) will not be liable to tax, therefore such companies pay only an annual fee, which is currently 600.

Shareholders in such companies may receive distributions free of Guernsey tax.

The same principle applies to the international partners of limited partnerships, whose share of the profits are not liable to Guernsey tax.

(Further information concerning the taxation of companies is contained in chapter 3).

There are no statutory withholding tax requirements in the Income Tax Law. Income paid to a non resident which is taxable may be charged on the paying agent, however.

The taxation position of a trust will similarly depend on the source of the income and the residence status of the beneficiaries

(eg. a trust, the income of which consists solely of deposit interest, and the beneficiaries of which are non resident, will not have a Guernsey tax liability).

# 5 FINANCIAL SUPERVISION/REGULATION POLICIES AND STRUCTURES

### 5.1 Government policy and responsibilities

The policy of the parliamentary bodies within the Bailiwick is to ensure that the supervision and regulation of finance business is of a standard at least equivalent to that in the United Kingdom, the European Union and the Organisation for Economic Co-operation and Development. Supervision and regulation closely follows United Kingdom models, but is constantly reviewed and the Island has a good record of having modern, up-to-date legislation (see Appendix 1).

The mandate of the Advisory and Finance Committee requires it, amongst other matters, to watch over the interests of the financial services sector and to promote such legislation as is considered necessary to regulate or assist the sector. The States of Alderney Policy and Finance Committee has similar responsibilities and is required to liaise and negotiate with the States of Guernsey on all matters relating to finance. With regard to Sark, the General Purposes and Advisory Committee has similar functions.

Until February 1988 when the Guernsey Financial Services Commission ("the Commission") commenced operations, day-to- day responsibility for the development and supervision of financial services business in the Bailiwick lay with the Government of each island although certain Bailiwick-wide matters fell to the Advisory and Finance Committee in Guernsey.

Financial supervision by the Advisory and Finance Committee dates back to at least 1947 when the Borrowing (Control) (Bailiwick of Guernsey) Law, 1946 ("the Control of Borrowing Law") came into force. In broad terms, the purpose behind this law was to control credit within the Bailiwick's economy. In essence, the Control of Borrowing legislation required the Advisory and Finance Committee's consent to be sought in respect of the raising of money in the Bailiwick by the issue of shares by a company (including the formation of a company); the raising of money outside the Bailiwick by the issue of shares; the borrowing of certain amounts of money and the circulation of a prospectus. The legislation has also been helpful to the authorities in monitoring the quality of companies which may be incorporated in the Bailiwick. (This legislation was later extended to cover the issue of units in a unit trust scheme and partnership interests in limited partnerships).

The Control of Borrowing Law and ordinances made thereunder ("COB") remain in force and are still utilised, amongst other matters, to supervise the formation of Guernsey and Alderney incorporated companies and the establishment and administration of closed-ended funds. Any consent granted under COB can at any time be made subject to conditions. Responsibility for the administration of the legislation remains with the Advisory and Finance Committee although the day-to-day administration of the legislation has been delegated to the Commission.

The next major legislation governing financial services activity was the Protection of Depositors, Companies and Prevention of Fraud (Bailiwick of Guernsey) Law, 1969 and the Protection of Depositors (Bailiwick of Guernsey) Ordinance, 1971 which, amongst other matters, gave the Advisory and Finance Committee power to register or refuse applications for registration as a bank subject to such conditions as it thought necessary or expedient to impose. Those parts of the Protection of Depositors legislation applicable to banking activity have been superseded by the Banking Supervision (Bailiwick of Guernsey) Law, 1994.

In April 1986, the States of Guernsey resolved to establish the Guernsey Financial Services Commission as a statutory body dedicated to overseeing financial business in the Bailiwick. It was the intention from the start that the Commission would be managed by experienced professionals as the Bailiwick was determined to set high standards. The first Director General and several of his colleagues were from a Bank of England background. They were joined by an experienced insurance supervisor. With these experienced executives at the helm and counselled by worldly and professional Commissioners, the

Commission's ambition over the past ten years has been to establish a reputation for stability, clarity and for being sound, firm and fair. Supervision and regulation has been undertaken to the highest international standards and by pursuing a policy of selectivity, only quality institutions have been permitted to establish within the Bailiwick.

### 5.2 Supervisory/regulatory style and related jurisdictions

The Bailiwick's style of financial services supervision and regulation can be described as strongly influenced by that in the United Kingdom. There are obviously differences between the Bailiwick and the United Kingdom just as there are differences between the three Crown Dependencies, but many of the laws which affect financial services business are based on United Kingdom law. To a lesser degree, legislation in the other Crown Dependencies influences Bailiwick financial services legislation.

Each of the Commission's Divisions is responsible for the enforcement activity specified in the legislation which a particular Division administers. The enforcement section of the Director General's Division is responsible within the Commission for enforcement and allied matters in connection with criminal or potential criminal activity. Each Division cancels, revokes, withdraws or imposes conditions on registrations, permissions, authorisations, licences and consents as appropriate. In addition, the Commission follows up all complaints in order to ascertain whether there are any supervisory/regulatory issues arising from those complaints. Prosecutions in the Courts are conducted by the Law Officers or Crown Advocates. Further details are contained in chapter 17.

### 5.3 Legislation and terms of reference

The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 ("the Commission Law") provides the Commission with general and statutory functions.

The general functions of the Commission include the development and supervision of finance business in the Bailiwick, assisting the Advisory and Finance Committee and the Policy and Finance Committee of the States of Alderney on any matter connected with finance business and making recommendations to the Committees for the statutory regulation of finance business.

The statutory functions of the Commission includes its general functions, any other functions assigned to it and the provision of assistance to the Advisory and Finance Committee where the Committee has functions relating to finance business.

In the exercise of its general functions the Commission may take into account any matter which it considers appropriate, but must in particular have regard to:

(i) the protection of the public against financial loss due to dishonesty, incompetence or malpractice by persons carrying on finance business; and

(ii) the protection and enhancement of the reputation of the Bailiwick as a financial centre.

### 5.4 Independence and accountability, including annual reports, links with Government and Parliament

Although established by the States of Guernsey, the Commission acts independently in the discharge of its functions. It is not a Committee of the States but a body corporate with perpetual succession and a common seal.

The Commission is required to make a report to the Advisory and Finance Committee on its activities during the preceding year. The report is also laid before the States. In addition, the Commission is required to lay true and fair audited accounts before the States each year.

The Advisory and Finance Committee may, after consulting the Commission, give to the Commission written guidance of a general character and written directions of a general character concerning the policies to be followed by the Commission. In addition, a continuing link between the two bodies is provided for in that the President of the Advisory and Finance Committee is (ex officio) the Chairman of the Commission.

### 5.5 "Board" structure and operation

The Commission's "Board" is constituted of the Commissioners, who fulfil a function similar to that of non-executive directors.

The "Board" consists of five Members, of whom:

(a) the Chairman is the President of the Advisory and Finance Committee; and

(b) the other four Members (Ordinary Members) are persons elected by the States of Guernsey from persons nominated by the Advisory and Finance Committee.

The Chairman may appoint a member of the Advisory and Finance Committee to represent him on the "Board".

Each of the Ordinary Members of the Commission holds office for three years, renewable by agreement, although they must retire from office on reaching the age of 72.

The Commission's policy is to hold ten meetings each year. Under the Commission Law the Commission is required to keep proper minutes of its proceedings, whether those proceedings are by way of meetings or by way of circulation of papers. The minutes are maintained for all Commission meetings held since February 1988 on Commission premises. In addition, the Director General and the Directors (or their deputies) meet routinely once a week in order to discuss matters of significance or interest. As the senior management work alongside each other, other meetings can and are held at short notice as required.

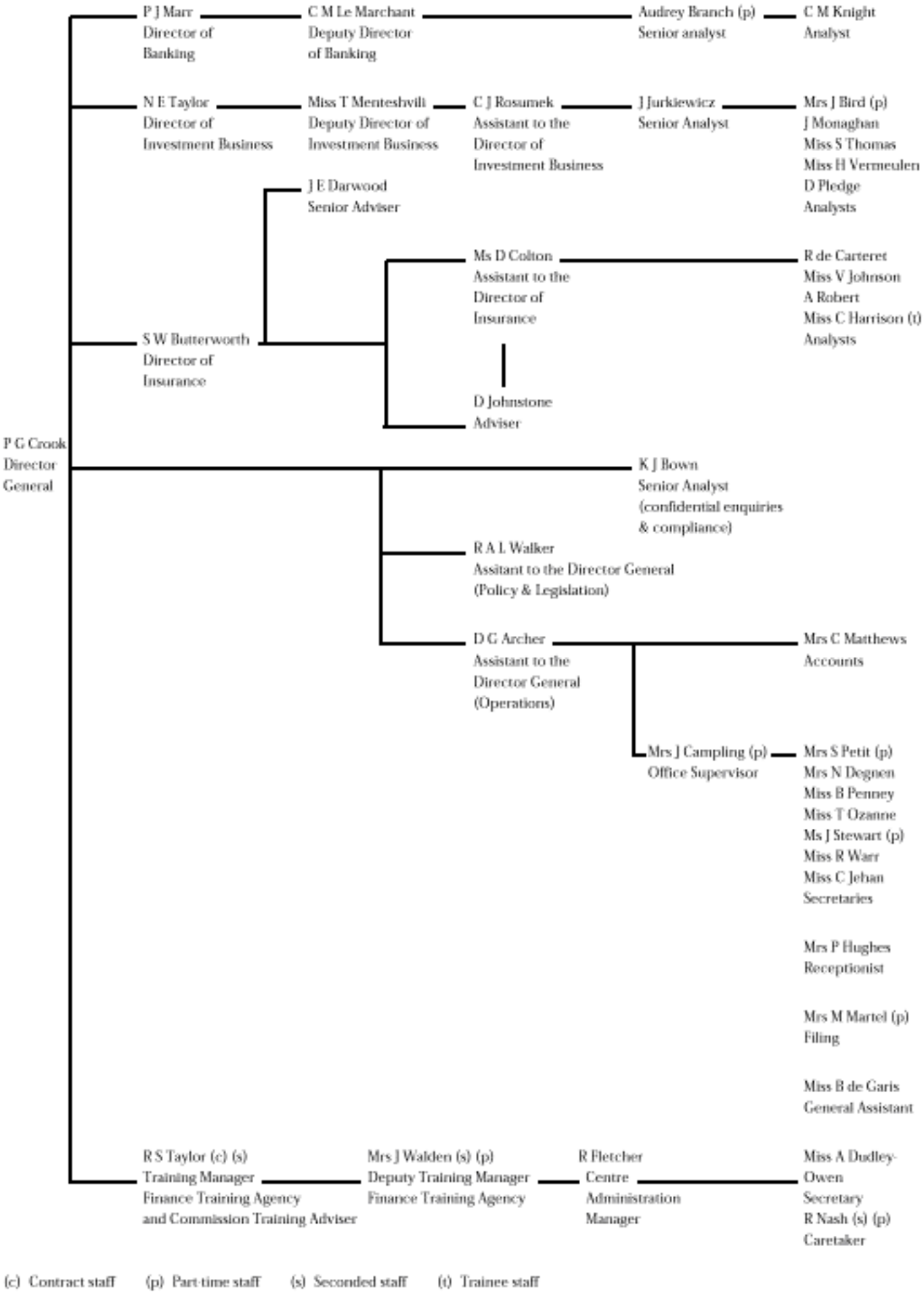
Every Member of the Commission, before discharging any function as a Member, is required to make an affirmation before the Royal Court. Members are also required to provide the Commission with a schedule of all of the directorships which they hold.

A Commissioner who has any direct or indirect personal interest in the outcome of the deliberations of a Commissioners' meeting in relation to any matter is required to disclose the nature of his interest at the meeting and the disclosure must be recorded in the minutes of the Commission. As a result of such disclosure they may be asked to leave the meeting. The senior management of the Commission do not hold outside directorships or have outside business interests. Any directorship or interest proposed to be held by any member of Commission staff must first be authorised in writing by the Director General.

The "Board" structure and composition of the Members of the Commission is laid down by law. The Commission's management structure and organisation is a matter for the Commission and is set out in the attached organogram.

**GURNSEY FINANCIAL SERVICES COMMISION**

**Commission Organogram as at August 1998**




The Commission's senior executive is known as the Director General and that person has overall responsibility for the day-

to-day activities of the organisation.

The Commission consists of four main divisions. Three divisions (the Banking, Insurance and Investment Business Divisions) are headed by a Director responsible for that Division's operations. The Director General is responsible for the fourth sector of the Bailiwick's finance sector, the fiduciary (trust and company) sector. His Division also covers international affairs, coordinates enforcement, researches new legislation and provides support to the other Divisions. A fiduciary business law is expected to be enacted next year which may lead to the introduction of a further Division and the appointment of a Director.

Senior staff are carefully chosen and are expected to have wide experience, often in other jurisdictions.

The Director General's Division comprises eleven staff, consisting of the Director General, three senior staff and seven support staff. In addition to its own activities the Division constitutes a core resource utilised by other Commission staff. The Director General's Division is also able to ask the Law Officers for assistance and utilises the services of a legal consultant (an Advocate) on an ad hoc basis.

The Banking Division comprises five staff, the Insurance Division comprises nine staff and the Investment Business Division comprises eleven staff. Further information on Divisional staff resources is provided in chapters 6, 7 and 8.

### 5.6 Finance Training Agency

While not directly involved with the supervision or regulation of finance business the Finance Training Agency Limited ("FTA") is an associated organ of the Commission. This reflects the Commission's commitment to ensuring that staff in the finance sector are well-trained and fit and proper. The purpose of the FTA is to develop within the Bailiwick a disciplined approach to financial services education and training and to work with the finance sector to that effect.

The activities of the FTA fall into two broad categories, services and support to the student body and the facilitation of course provision on Guernsey. The latter is a particular benefit of the FTA as it will increasingly reduce the need for local finance sector staff to travel to the United Kingdom or utilise distance learning specialists for their education and training needs.

The FTA consists of a Training Manager, two senior staff and two support staff. The FTA also utilises the Director General's Division at the Commission for a number of functions such as the administration of its accounts.

### 5.7 Who decides individual cases and licences?

The Commission Law provides for the Commission to delegate to its officers the ability to cancel, revoke or withdraw any registration, permission or authorisation. In practice the officers of the Commission decide the vast majority of the individual cases and licences. Reports are made at Commissioners' meetings by each Division's representative (usually the Director) on the decisions taken on registrations, permissions or authorisations issued by the division since the previous meeting. From time to time decisions on such matters are taken to the Members for consideration. Issues for consideration by the Members include those where specific ratification of senior management's decisions may be desirable.

The same policy applies across all of the Commission's activities, including the day-to-day administration of the Control of Borrowing legislation. The only difference here is that, as the Advisory and Finance Committee retains overall responsibility for the legislation formal written procedures are in place providing for certain officials of the Commission to administer the legislation on behalf of the Advisory and Finance Committee.

The officers of the Commission also become involved with complaints by depositors, investors and policyholders. Although the Commission is not an ombudsman, its staff have been able to intervene successfully for complainants on a number of occasions. The number of complaints is not high in relation to the size of Guernsey's finance centre. The Commission's policy is to put in writing all supervisory and regulatory decisions reached. In addition, any decisions reached during meetings are confirmed in writing.

### 5.8 Documentation and filing

All documentation which refers to a decision by Commission staff, together with the reasons for a decision, are retained by the Commission. During compliance visits Commission staff stress that institutions should maintain evidence of compliance, actions taken and the reasons for those actions. The Commission imposes no less a high standard on its own activities and all files established by the Commission (and files established by the Advisory and Finance Committee prior to 1 February 1988 pertinent to financial supervision and regulation) have been retained within the Commission or its archive facilities.

### 5.9 Financing

The Commission Law enables the Commission to levy fees and charges and the Commission's financing mostly stems from the payment of fees by the institutions it supervises/regulates. The fees are levied by means of regulations subject to approval by the States of Guernsey. In addition, the Advisory and Finance Committee may make a grant to the Commission from the States General Revenue Account towards the expenses of the Commission in carrying out its functions. During 1997 the Commission received 100,000 in respect of its activities in relation to the development of the Finance sector activities and 50,000 for its administration of COB from the Advisory and Finance Committee.

### 5.10 General supervisory/regulatory policy

It has been the Commission's intention to establish uniform standards over its areas of supervision and regulation. Certain policies/ criteria, such as those on selectivity, fitness and properness and "four-eyes" are common to all supervised/regulated entities and other financial institutions.

In addition, the Commission has established policies or guidelines for all financial institutions, whether or not supervised/ regulated. Such policies and guidelines are statements of the standards expected of all such institutions. Examples of this include:

(a) the Principles of Conduct of Finance Business which follow the principles issued by supervisory and regulatory bodies in the United Kingdom;

(b) the Principles of Conduct of Derivatives Business which are a distillation of principles, guidelines and risk analysis issued by international and other organisations and supervisors/ regulators; and

(c) the Guidance Notes on the Prevention of Money Laundering. These Guidance Notes are issued by the Joint Money Laundering Steering Group, a body containing representatives of the Commission, law enforcement agencies and the finance sector.

# 6 BANKING BUSINESS

### 6.1 Policy

The general duty of the Guernsey Financial Services Commission ("the Commission") to protect and enhance the Bailiwick's reputation as a finance centre is reflected in its approach to banking supervision. There is a policy of selectivity which, in the context of establishing a new bank, means that it is expected to be of high reputation and standing, with an established track record and add to Guernsey's reputation as a finance centre. The bank should also contribute materially to the economic well-being of the Bailiwick through payment of tax on its profits.

### 6.2 Legislation

The essential legal framework for the supervision of banks in Guernsey is the Banking Supervision (Bailiwick of Guernsey) Law, 1994 ("BSL"). This legislation is largely modelled around the United Kingdom's Banking Act of 1987. The principal difference in the requirements established under the BSL is that licensed banks are required to make an economic contribution to the Bailiwick. Hence the banking supervisors are required to have regard for the economic benefit which individual banks make to the Bailiwick; the economic benefit will be transmitted through a bank's locally generated profits and tax paid to the Income Tax Authority. That said, prudential issues always take precedence. Under the BSL the following regulations have been made: the Banking Supervision (Bailiwick of Guernsey) Regulations, 1994. These are regulations on exempt transactions, deposit advertisements, matters to be communicated to the Commission and exempt persons. The following rules have also been made under the BSL: the Banking Supervision (Accounts) Rules, 1994. These stipulate what should be included in a bank's audited accounts and when they should be submitted to the Commission.

### 6.3 Resources

The Banking Division has five staff consisting of two Directors, one senior member of staff, one analyst and one secretary. The Division also uses the core resources available in the Director General's Division (which includes the former Director of Banking). The Division is also able to call on the services of the Law Officers and a legal consultant.

### 6.4 Conformity with the Basle Committee on Banking Supervision's twenty-five Core Principles for Effective Banking Supervision and with European Union Directives

The Commission has reviewed the Core Principles document and is satisfied that it meets all twenty-five. As a founder member of the Offshore Group of Banking Supervisors Guernsey fully endorses and supports the introduction of the Core Principles. Guernsey is not a European Union Member and does not need to comply with European Union Directives. The Commission monitors all of the European Union's pronouncements. In complying with Basle Committee requirements the Commission also complies with European Union Directives applicable to deposit-takers, with the sole exception being that there is no deposit protection scheme in Guernsey (see below).

### 6.5 Basle Concordat - capital adequacy

In 1989 Guernsey banks were informed that a minimum risk asset ratio (calculated in accordance with the Basle Committee on Banking Supervision's paper : "International Convergence of Capital Measurement and Capital Standards") of 10% would be introduced for Guernsey banks with effect from July 1990. This is substantially stricter than the proposed Basle minimum of 8% set by Basle to be met by 1992. Currently the weighted average risk asset ratio for Guernsey banks is 18.81% with the

minimum of 10% being adhered to by all banks.

### 6.6 Licensing and structure policies

Banks wishing to carry on deposit-taking business in the Bailiwick of Guernsey require a licence under the BSL. The subsection entitled "Policy" above outlines the Commission's approach to new licences and potential licensees. Banks are required to make a formal application which requires them to provide details on : staff/ management/directors - all of whom have to complete and submit a detailed Personal Questionnaire; group structure; financial information and business plan; money laundering avoidance policy; and subsidiaries have to provide a letter of comfort from their parent organisation(s) and confirmation that capital is in place. The Commission will not licence a bank until the home supervisor (ie the supervisor of the parent bank) has confirmed that it wishes to raise no objection to its bank establishing a branch or subsidiary in Guernsey. The home supervisor is also asked to confirm that it will supervise the Guernsey bank on a consolidated basis.

### 6.7 Relations with home country supervisors, International bodies and conventions, Memoranda of Understanding

The Commission is a founder member of the Offshore Group of Banking Supervisors which is associated to the Basle Committee on Banking Supervision and, as such, meets annually with the Offshore Group. Every second year the Offshore Group organizes its meeting to coincide with the International Conference of Bank Supervisors at which supervisors from all around the world are present.

In 1997 the Deputy Director of Banking attended the Ninth International Banking Supervisor's course held in Basle and arranged by the Basle Committee. This seven day residential conference was attended by banking supervisors from 36 different countries.

The Commission has (on the banking side) draft Memoranda of Understanding in the process of being negotiated with the Bank of England, the Jersey Financial Services Commission and the Federal Deposit Insurance Corporation of the United States of America. Responses to Commission drafts are awaited from all three jurisdictions.

In practice the Commission has regular meetings, conversations and correspondence with overseas supervisors and regulators to discuss issues of mutual concern. The Division undertook three days of meetings with supervisors at the Bank of England last year discussing issues of common interest with the respective consolidated banking supervisor of the Guernsey bank's parent at the Bank of England. The meetings covered several of the small merchant banks, the Guernsey subsidiaries of several former building societies, and ongoing issues in the private banking subsidiaries and branches of the clearing banks. In future the Commission intends to undertake bi-lateral discussions with Jersey and Isle of Man supervisors in respect of the Guernsey branches of offshore banks established in those Islands. The Commission also intends to visit Switzerland again to speak with the primary bank supervisor of the leading Swiss banks with operations in Guernsey.

Aggregate banking information on money flows is provided monthly to the Bank of England to assist the United Kingdom with its calculation of monetary aggregates.

### 6.8 Supervision of subsidiaries and branches, including lending

The methodology of supervision includes the off-site analysis of prudential returns submitted quarterly by banks. This is followed up with a prudential meeting with the bank on-site on its own premises for a discussion between the Banking Division and typically the top two or three personnel in the bank.

For subsidiaries, the full range of capital adequacy monitoring is employed - ie assets are classified by risk weight and measured against the designated supervisory capital base. Minimum risk asset ratios are set for each bank. The minimum for the leading banks is a risk asset ratio of 10%; others range from 12% to 16%. Liquidity adequacy is analysed using the cumulative mismatch technique. All banks are required to submit detailed quarterly prudential returns and monthly statistical returns.

Branches have to provide similar information to subsidiaries but (of course) are not required to calculate a risk asset ratio. Liquidity monitoring is the Commission's prime international supervisory responsibility in the case of branches. However,

branches are, in practice, supervised in much the same way as subsidiaries with annual (at least) on-site prudential visits taking place at both branches and subsidiaries. Prudential meetings cover the whole range of bank risks as well as credit and interest rate risks and include:

(i) systems adequacy/disaster recovery/ Year 2000/EMU and so forth;

(ii) staffing adequacy/vacancies/housing licence requirements;

(iii) know your customer procedures, client take-on risks, money laundering avoidance and anti-fraud measures;

(iv) target markets and any reputational risks arising from particular markets;

(v) profitability analysed by business streams;

(vi) budget planning and expectations of parent or head office;

(vii) new products - the Banking Division discusses plans for new products and services and the associated risks;

(viii) management letter from auditors; and

(ix) internal controls and the scope and resourcing of internal audit.

The Commission closely watches, and has issued a paper on, large exposures (Principle 1/1994/24), the objective behind this being to avoid concentration risk. There are limits on the aggregate of large exposures and there are single exposure limits. Subsidiary banks must notify the Commission of any exposures over 25% of their capital base which they intend to undertake. Acknowledgement is required from the Commission before a bank undertakes a large exposure.

From time to time the Division may commission a special exercise either across all banks or selectively focused on particular banks to examine high level controls or other systems and control issues; in 1996/1997 an exercise was commissioned on the upstreaming of information to parent/head office. The Commission reserves the right to commission such exercises on a need basis to supplement its own supervisory resources. The Commission will arrange tri-lateral meetings with auditors on a need basis rather than on a routine, mandatory basis. These will be driven by the Commission's judgement of the need for discussion based on any risks identified or suspected arising from the audit or the management letter. A policy statement on procedures at tri-lateral meetings was produced by the Commission in March 1997.

Supervisory returns may be required to be verified by an external auditor, in arrears, at any time. The Commission has recently decided to randomly verify quarterly returns on at least an annual basis for all banks and the first verification procedures have begun.

### 6.9 Liquidity

The quarterly prudential return requires all banks to complete an assets and liabilities maturity ladder. Generally, the Commission would not expect a bank to have a cumulative negative mismatch of more than 20% of weighted assets at one month maturity.

### 6.10 Administered banks with no stand-alone presence

See the subsection on administered banks in chapter 3.

### 6.11 Comprehensive risk assessments

The Commission carries out a pre-visit risk assessment analysis before each prudential meeting. This is made easier by the physical proximity of the banks and the depth of knowledge possessed by the Commission on the banks operating in the Bailiwick.

The Commission was involved in the pilot exercise for the RATE (Risk Assessment Tools (of Supervision) and Evaluation) analysis carried out by the Bank of England in its analysis of group-wide risk. The Bank considered the Commission's input to be of great help.

### 6.12 Management quality

The Commission has close and regular contact with the senior management of all Guernsey banks. All directors, branch managers, company secretaries and managers reporting directly to the board have to complete Personal Questionnaires which assist in the Commission's decision as to whether such individuals are acceptable. The criterion used to assess acceptability is the fit and proper criterion (which has been adopted from the Bank of England). In summary, it requires senior staff to be honest, competent and solvent. The Commission also exercises the "four-eyes" criterion in assessing the management of a bank.

The Commission attaches great importance to the quality of staff in Guernsey and, through the Finance Training Agency, the Commission is dedicated to ensuring that quality is maintained and improved in the medium and long term by facilitating on-Island training in financial services.

Essential housing licences are granted to non-Guernsey senior staff occupying "essential" jobs in the finance sector. If the Commission considers a rle is essential to the island of Guernsey, and the post cannot be filled locally, the Commission supports applications for housing licences. This also ensures that the Island benefits from experience and skills obtained outside the Island which can be passed on to, and assimilated by, the local workforce.

### 6.13 Off-site and on-site supervision

All prudential routine meetings are held at the offices of the bank concerned. These meetings are carried out at least annually for all banks. Commission staff examine selected documentation on-site, review the premises and are introduced to all senior staff. External auditors are also used by the Commission to carry out high-level control checks (see the subsection above on the supervision of subsidiaries and branches).

Like the Bank of England, a large part of the Commission's supervision is carried out through off-site analysis of quarterly and monthly returns together with a desk-top assessment of risk.

A decision was made in June 1997 to initiate systematic on-site reviews of banks in line with the Basle Committee's Core Principles targeting specific areas of internal controls or business. It is intended that the first of these will be carried out in late 1998 or early 1999. The Banking Division has wide experience in on-site visits and its staff also have first hand experience of working in the local, Jersey and London finance sectors.

### 6.14 Internal management and control systems, including segregation of duties

This is treated as a matter of great importance by the Commission. Internal controls are discussed in detail during prudential meetings (where they are a standard agenda item) and auditors are used by the Commission to report on high-level controls (see the subsection above on the supervision of branches and subsidiaries). The Commission monitors the visits to banks by their internal auditors and liaises with them. External auditors' management letters (at the conclusion of the annual audit) are required to be copied to the Commission by all subsidiary banks.

### 6.15 Information systems

Again, this is a standard agenda item for prudential meetings. The Commission discusses banks' information technology systems, information technology requirements, information technology support and, in particular, highlights the potential problems with the introduction of the euro and "Year 2000 problems". The Division is currently carrying out an inventory of banks' information technology systems and support and monitoring their progress to "Year 2000 compliance". The Commission has twice written to all banks highlighting the potential problems associated with the Year 2000. The Commission has also written to all banks in order to ascertain their progress on "euro compliance".

Generally, the quality of information technology systems is high in Guernsey and banks often benefit from external group support in this area. Banks seem to be well aware of information technology problems and are alert to dealing with them efficiently.

### 6.16 Non-banking activities

This is not a straightforward classification. Apart from the offshore deposit gatherers (eg subsidiaries of United Kingdom and Irish building societies and former building societies) banks in Guernsey carry out far more than mere deposit-taking. Primarily, they are involved in investment management, trust administration and custody business (see chapter 3). The Commission monitors and supervises banks' businesses as a whole and all aspects of the bank (both on and off balance sheet) are discussed at prudential meetings to analyse the potential risks to each institution.

### 6.17 Anti-fraud

The Banking Division works closely with other Divisions in the Commission in the investigation of potential breaches of the BSL. It also assists law enforcement agencies where it is required and permitted to do so. Prevention of money laundering and anti-fraud measures of banks are discussed at prudential meetings and banks co-operate closely with the Commission on the reporting of suspicious potential transactions and suspicious approaches from customers.

### 6.18 Supervisors' ability to intervene

As banking supervisor the Commission has several statutory powers to intervene. These include powers to:

(a) refuse or revoke banking licences;

(b) impose conditions on banking licences;

(c) make regulations;

(d) issue directions to banks;

(e) object to controllers of banks;

(f) restrict the sale of bank shares;

(g) control deposit advertisements;

(h) obtain information and documents;

(i) have a right of entry to obtain information and documents;

(j) appoint inspectors;

(k) investigate suspected offences;

(l) apply to the Court for repayment of unauthorised deposits and profits;

(m) apply to the Court for injunctions to restrain unlawful deposit-taking etc.;

(n) apply to the Court to wind up a company;

(o) restrict the use of certain names;

(p) disclose information to certain third parties;

(q) establish a compensation depositor protection scheme (see below); and

(r) have information verified.

### 6.19 Enforcement

The Commission has exercised and threatened to exercise some of these powers. Regulations have also been produced by the Commission and investigators have been appointed. The Commission exercises its powers to obtain information (and have it verified) regularly. Conditions (of a general nature) have been imposed on banking licences. The Commission is not a prosecuting authority.

All banks (deposit-takers) in the Bailiwick are supervised by the Commission under the BSL and all banks must be licensed under the BSL. The Bailiwick does not possess underground banking systems. The Commission carries out investigations when in receipt of information which raises a suspicion that unlawful banking business is being carried on in the Bailiwick. Where information is gleaned by the Commission to the effect that a person may be intending to offer deposit-taking activity, the Commission investigates and takes remedial action. (See chapter 17).

The Commission also draws to the attention of foreign banking supervisors information of which the Commission is aware which raises a suspicion that a person or legal entity incorporated, managed or administered in the Bailiwick is carrying on banking business in any other jurisdiction where it appears that he or it may be unlicensed.

### 6.20 Depositor protection scheme

Part 4 of the BSL provides for the States of Guernsey to introduce a depositor protection scheme. Current policy is not to introduce such a scheme. The Commission considers that the best way to protect depositors is to continue to allow only banks of the first rank to establish in Guernsey and that any funded compensation scheme would incur costs which would be passed on to depositors and other clients. In addition, a compensation scheme on the scale of most existing schemes would provide small comfort to the typical, high-sum depositor with Guernsey banks and any scheme significantly more generous would be unduly burdensome on the banks. However, the Bailiwick can introduce a scheme at short notice should it become a necessity.

### 6.21 Oversight of bureaux de change

The activities of bureaux de change are not supervised since they do not engage in deposit taking activities, although of course the bureaux operated within banks are operated within institutions which are supervised under the BSL. The Commission ensures that bureaux de change are aware of the principles and procedures involved in preventing and countering money laundering.

# 7 INVESTMENT AND SECURITIES BUSINESS

### 7.1 Policy/comparison with United Kingdom

While much of the detailed regulation reflects that which applies in the United Kingdom under its Financial Services Act, the Guernsey rgime is distinguished from the United Kingdom's by Guernsey's policy of selectivity described above. In consequence, some nine applications from persons authorised under the Financial Services Act to establish collective investment funds in Guernsey have been refused over the past ten years.

### 7.2 Legislation

The legislation under which investment business is regulated is the Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended ("POI Law"). The POI Law requires persons who, by way of business, carry on "restricted activities" in connection with "controlled investments" to be licensed. "Restricted activities" comprise promotion, subscription, registration, dealing, management, administration, advising and custody. Controlled investments originally comprised open-ended collective investment schemes but, with effect from 1 July 1998, the categories of controlled investments were extended to include shares, debentures, closed-ended investment schemes, warrants, options, futures and contracts for differences, together with other investments. In essence, the scope of the extended POI Law reflects the United Kingdom Financial Services Act with the exception of long-term insurance business/pensions - the former and certain pension products are already supervised under the Insurance Business (Guernsey) Law, 1986, as amended and the Insurance Division of the Commission is currently reviewing recent and proposed legislation on pensions in other jurisdictions with a view to submitting further legislative proposals to the States of Guernsey in due course.

### 7.3 Resources

The Investment Business Division, which is responsible for the administration of the POI Law, comprises 2 Directors, 2 Senior Managers, 5 Analysts and 2 secretarial support staff.

### 7.4 Enforcement

The following enforcement powers are available to the Commission under the POI Law, namely powers to:

(i) refuse a licence;

(ii) impose conditions on licensees;

(iii) cancel or suspend a licence;

(iv) refuse to authorise an open-ended collective investment scheme;

(v) impose conditions on an authorised collective investment scheme;

(vi) revoke or suspend the authorisation of a collective investment scheme;

(vii) obtain information and the production of documents;

(viii) report to their professional body auditors who fail to comply with the requirement to inform the Commission of concerns regarding licensees/ authorised schemes/ unlicensed clients who appear to be carrying on investment business; and

(ix) apply to the Royal Court to grant injunctions and restitution orders.

In addition, the POI Law prescribes offences (eg carrying on unlicensed investment business, furnishing false information, acting with fraudulent intent, making misleading, false or deceptive statements and removing/ destroying books and papers, criminal liability of directors/managers) which carry penalties of imprisonment for up to two years, or a fine, or both.

### 7.5 Links with United Kingdom and other overseas regulators Exchanges of information Memoranda of Understanding ("MOUs") Membership of international bodies

In order to carry out due diligence on prospective licensees and collective investment funds, the Investment Business Division is in regular contact with overseas regulators.

These include IMRO (Investment Management Regulatory Organisation), SFA (Securities and Futures Authority), PIA (Personal Investment Authority), DTI (Department of Trade and Industry) and London Stock Exchange in the United Kingdom, the SEC (United States Securities and Exchange Commission), NASD (National Association of Securities Dealers), United States CFTC (Commodity Futures Trading Commission), the Swiss Federal Banking Commission, the Hong Kong SFC (Hong Kong Securities and Futures Commission), COB (Commission des Oprations de Bourse), CFB (Commission Bancaire et Financire), CONSOB (Commissione Nazionale per le Societ e la Borsa), the Monetary Authority of Singapore, the South African Financial Services Board, Australian Securities Commission, British Columbia and Ontario Securities Commissions. The Investment Business Division is also in regular contact with the FSA/IMRO Collective Investment Scheme Unit in connection with Class A collective investment schemes recognized by the FSA under section 87 of the United Kingdom Financial Services Act.

Section 21 of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987 provides a gateway to disclose information "in the interests of the prevention or detection of crime" and "to assist, in the interests of the public, any authority which appears to the Commission to exercise in a place outside the Bailiwick functions corresponding to those of the Commission" and the Investment Business Division have been pro-active in this respect by frequently advising overseas regulators of relevant matters which have come to their attention, and not merely responding to requests for information from overseas regulators.

While the Commission is always willing to consider entering into MOUs, its experience shows that these are no substitute for informal exchange of intelligence based on mutual trust. A prime example of the latter scenario is the Commission's relationship with the SEC, undoubtedly helped by the Guernsey authorities' assistance in the case of SEC v Pacific Waste Management described in the SEC's 1993 Annual Report as "another example of extraordinary co-operation".

However, MOUs/Agreements have been entered into with the Australian Securities Commission and De Nederlandsche Bank (in connection with the marketing of Guernsey funds in Australia/The Netherlands), IOSCO -Resolution Concerning Mutual Assistance (under which the Commission agreed to provide assistance on a reciprocal basis to the other IOSCO member agencies which are also signatories), and with the Hong Kong Securities and Futures Commission, the United States Commodity Futures Trading Commission and CONSOB, Italy (in connection with exchanges of confidential information).

The Commission is a member of two international bodies which are of particular relevance to investment business. First the Commission, which had been an active associate member of IOSCO since 1991, and at their invitation had contributed to IOSCO Working Party No 4's survey on "cross-border measures to protect defrauded investors' interests and assets", was admitted to full membership in November 1997. Secondly, in September 1995 the Commission was admitted to membership of the Enlarged Contact Group on the supervision of Collective Investment Funds ("ECG"). The ECG's principal objective is the exchange of information and ideas between regulators of collective investment funds, and its members include regulators from the USA, Canada, Japan and the Member States of the European Union.

### 7.6 Investment business services

As a leading international finance centre, Guernsey institutions provide a full range of investment business services, such as

asset management, investment advice, stockbroking, custody of assets, securities dealing services, including the use of derivatives.

### 7.7 Licensing and licensing criteria/processes

As indicated under "Legislation" above, these services are licensable activities and applicants are required to submit a detailed application form, a (non-refundable) application fee, and Personal Questionnaires on directors and senior staff (unless they provide confirmation that they have satisfied the United Kingdom authorities as fit and proper persons for the purposes of the United Kingdom Banking, Insurance Companies or Financial Services Acts). If the applicant meets the policy of selectivity, and no adverse information is obtained as a result of the Investment Business Division's due diligence enquiries, the application is considered against the following inter-dependent criteria:

(a) fitness and properness;

(b) general nature and specific attributes of business;

(c) organisation of business and human resources; and

(d) economic benefit.

### 7.8 Investment business services - on-going regulation and Commission's ability to intervene

There are two elements in the on-going supervision of licensees to ensure that they remain fit and proper, namely:

(a) rules made under the POI Law; and

(b) compliance visits.

The rules made under the POI Law encompass financial resources requirements, conduct of business, compliance arrangements and notification requirements. The latter impose a requirement on licensees to provide immediate notification to the Commission of specific events or circumstances, such as changes in ownership or senior personnel, any legal or disciplinary action against licensees or their employees, details of significant complaints against licensees, together with other matters.

The Commission makes pre-arranged compliance visits to licensees who are "designated" managers or "designated" trustees/custodians of authorised collective investment schemes, the results of which are reported to the boards of the licensees concerned (and on occasion to the board of a United Kingdom parent company); if necessary, follow-up visits are arranged.

Unannounced compliance visits have also been made as a result of concerns following the receipt of "market intelligence", and have resulted in the revocation of authorisation of collective investment schemes.

It is not the Commission's practice to make routine compliance visits to other licensees, although such visits will be made if there are complaints or concerns arise about the continuing fitness and properness of a licensee. In this context, the Commission considers that a particular advantage of a small jurisdiction is that market intelligence/ the grapevine provides very speedy indications of problems, and a licensee can be visited within minutes.

### 7.9 Open-ended collective investment schemes

There are three classes of authorised open-ended schemes, A, B & Q, all of which are subject to detailed rules made under the POI Law:

(a) the Class A rules are modelled on the FSA regulations for collective investment schemes, and Class A schemes are eligible for recognition under section 87 of the United Kingdom Financial Services Act;

(b) the Class B rules allow more flexibility, consistent with meaningful investor protection, and are applied by the Commission exercising judgement and discretion and taking into account all the facts pertaining to a particular application;

(c) the Class Q rules provide a clear and concise set of requirements for funds aimed at institutions/high net worth individuals, with particular emphasis on disclosure.

All classes of scheme are subject to continuing supervision by the Commission, and may be established as unit trusts or OEICs (including protected cell companies ("PCCs")). In the context of an umbrella or multi-class fund, a PCC provides legal segregation of the assets of each class, thus avoiding any risk of contagion between the classes by protecting the assets of each class from the liabilities of the others.

### 7.10 Authorisation process

All three classes are subject to an identical three-stage application process:

(a) submission of an application for preliminary indication of acceptability. This is considered against the policy of selectivity and in the light of due diligence procedures, and, if acceptable, outline authorisation is issued;

(b) submission of detailed formal application, including Personal Questionnaires and drafts of constitutive documents, including scheme particulars. If the Commission is content, interim authorisation is granted, normally subject to amendments or clarification of documents submitted; and

(c) submission of signed or certified copies of final constitutive documents, including scheme particulars, and lawyer's certificate (confirming that the documents comply with the rules) as required under the applicable rules, followed by the issue of a formal letter of authorisation under the POI Law.

### 7.11 Valuation and pricing

(a) the Class A Rules contain detailed provisions regarding valuation and pricing reflecting the FSA Regulations which apply to authorised unit trusts (in 1997 the Commission submitted revised rules to reflect changes in the United Kingdom rgime since 1988, and these remain under consideration by H.M. Treasury).

(b) the Class B and Class Q Rules require the scheme particulars to contain detailed information regarding valuation and pricing and the manager and trustee/ custodian to comply with the principal documents and scheme particulars in relation to valuation and pricing.

The Commission has issued a guidance note on "Correction and compensation of incorrect pricing of authorised collective investment schemes" (whether A, B or Q) along the lines of similar guidance issued by IMRO.

### 7.12 Investment policies

The Class A rules contain detailed provisions regarding investment and borrowing powers (also reflecting the FSA Regulations which apply to authorised unit trusts). Again, the

Class B and Class Q rules are more flexible, requiring authorised schemes to invest and borrow within the limits disclosed in their scheme particulars.

### 7.13 Reporting and disclosure requirements

(a) For investors

The rules require authorised schemes to publish (and revise where required) detailed scheme particulars, and also to send reports and audited accounts to investors at least annually.

(b) To the Commission

The rules require designated managers of authorised schemes:

(i) to provide annual notification of any change in respect of the information contained in the application form for authorisation of a scheme; and

(ii) to give immediate notification of any proposal to change any parties to the scheme or of a proposed change of ownership of any such parties.

### 7.14 On-going regulation and Commission's ability to intervene

As with licensees, the main strands of on-going regulation are the various notification requirements which apply to authorised schemes and their operators, and compliance visits. As indicated under "Enforcement" above, the Commission has wide powers under the POI Law in relation to authorised schemes. These have been exercised robustly over the years, including the revocation of the authorisation of four schemes and cancellation of the licences of two managers connected with these schemes.

### 7.15 Fund managers/trustees/custodians - licensing procedure, criteria, separation

The POI Law requires an authorisation of a collective investment scheme to state the name of the designated manager and designated trustee or custodian of the scheme. Such licensees are known collectively as designated persons, and are subject to additional rules, the Collective Investment Schemes (Designated Persons) Rules, 1988. These are conduct of business rules covering areas such as financial records, best execution, keeping of records, contract notes, client money, compliance arrangements, complaints procedures and notification requirements. Designated persons are required to produce written compliance and complaints procedures and submit copies of these documents to the Commission.

As far as financial resources are concerned, designated trustees/custodians must maintain gross capital of 4 million and designated managers gross capital of 100,000 or 25% of their annual audited expenditure, whichever is the greater. The licensing procedure for designated persons is essentially that described under the subsection entitled "Licensing and licensing criteria/processes" above.

However, particular attention is paid (both at the outset and on subsequent notifications and compliance visits) to the directors and personnel of applicants in the light of the Commission's policy on separation between designated managers and designated trustees/ custodians of authorised schemes. The relevant rules under the POI Law require that the designated manager and designated trustee/custodian of an authorised scheme shall be different persons, act independently of each other, not be a subsidiary of the other, and not have executive directors or other officers in common.

### 7.16 Closed-ended funds

Closed-ended funds, such as investment trusts, can be formed as investment companies, unit trusts or limited partnerships and at 31 March 1998 these numbered 115, 46 and 36 respectively.

### 7.17 Authorisation criteria and procedures

The POI Law does not require closed-ended funds to be authorised (the POI Law is based on the United Kingdom Financial Services Act which similarly does not require investment trusts and other closed-ended funds to be authorised).

Closed-ended funds are, however, granted (or refused) consent under the Control of Borrowing legislation ("COB") and, in granting or refusing such consent, the Commission staff act as agents for the Advisory and Finance Committee.

In carrying out these delegated functions, the Commission applies the same criteria which apply to open-ended schemes, including the policy of selectivity. Thus account is taken of the status of the intended promoters, the nature of the scheme

including its investment, borrowing and hedging powers, the parties involved in the day-to-day operations of the scheme, the anticipated economic benefit to Guernsey, and any other factor deemed appropriate. All material facts must be clearly disclosed in prospectuses/ scheme particulars, and "health warnings" may be required.

As with open-ended schemes, applications for consent for closed-ended funds undergo the "three-stage" procedure described under "Authorisation process" above.

### 7.18 On-going regulation and regulator's ability to intervene

Consent is given to a closed-ended fund on condition that the prior agreement of the Advisory and Finance Committee is obtained to any changes in the operation of the fund, its constitutive documents, the parties involved in its operation or the ownership of those parties, and also to the delegation of those parties' duties. Closed-ended funds are also required to submit quarterly statistical returns and annual reports and accounts to the Commission.

COB prescribes penalties of a fine or imprisonment or both for contraventions, such as breaches of conditions, and empowers the Advisory and Finance Committee, amongst other matters, to obtain information. These powers of intervention were enhanced when the POI Law was extended on 1 July 1998, in that managers of, and other Bailiwick parties to, closed-ended funds now require to be licensed under the POI Law and the normal licensing criteria/ processes apply.

### 7.19 Stock Exchange

The Channel Islands Stock Exchange ("CISX") is being established as a stand-alone body with an organising Board. Before opening for business, the CISX will be required to be licensed to operate as an investment exchange by the Commission under the POI Law. The POI Law was amended on 1 October 1998 to empower the Commission to regulate the CISX and the Commission is preparing rules under the law to require the CISX to notify it of significant events relating to the CISX's key employees, its members, financial information and other information. The Commission is also reviewing the CISX's draft rules on membership and listing in order to satisfy itself that they will afford proper protection to investors.

# 8 INSURANCE AND PENSIONS BUSINESS

### 8.1 Policy

The Commission's general duty to protect and enhance the Bailiwick's reputation as a financial centre is reflected in its approach to the supervision of insurers.

There is a policy of selectivity which, in the context of insurers, means that great weight is given to the status of the intended shareholders, directors, officers and insurance managers. The offshore insurers are supervised mainly through their insurance managers who are required to demonstrate a favourable track record in their management practices.

Emphasis is placed on a self-supervisory approach when supervising insurers. The information provided with the application concentrates on three main factors: that the applicant is fit and proper, that the business plan is commercially acceptable, and that the management and control are resident in Guernsey. The Insurance Division is in regular contact with the general representatives (the vast majority being the insurance managers) who represent the offshore insurers. In this way, the Insurance Division is able to ensure that the management and control of the insurers and the business written by the insurers are continuously acceptable and in accordance with the standards and policies of the Commission.

The Commission's overall objective is to develop and effectively supervise insurance business in or from within the Bailiwick by:

(i) reinforcing high standards of integrity, fair dealing and competence by promoting clear, ethical, prudential business standards for the supervised entities which are appropriate to the type of business and type of customer concerned;

(ii) taking enforcement action: both on the Commission's initiative and in support of other overseas supervisors; to deter and detect improper or incompetent conduct; and to act against those who damage or put at risk the interests of investors or the integrity of the insurance markets; and

(iii) keeping regular and active contact with overseas insurance supervisors Current objectives Current objectives include:

**Current Objectives**

Current objectives include:

(i) carrying out a review of the insurance legislation;

(ii) to review and define more precisely the responsibilities of general representatives;

(iii) to develop new contacts and build on existing contacts in the international insurance supervisory and allied fields;

(iv) to continue to consult and co-ordinate the various parts of the Guernsey insurance sector through the Guernsey Insurance Forum which provides a channel of communication between the Guernsey authorities and the insurance sector; and

(v) to work closely with the Finance Training Agency to ensure that the training and education requirements of the insurance sector are adequately met and to work with the Life Education Committee in setting examination

standards.

### 8.2 Main legislation affecting the insurance sector

The main legislation affecting the insurance sector is:

(a) the Insurance Business (Guernsey) Law, 1986, as amended by the Insurance Business (Amendment) (Guernsey and Alderney) Law, 1997 and the Insurance Business (Amendment) (Guernsey and Alderney) Law, 1998 (together "the IBL"). It is proposed that the IBL should be extended to Sark later this year.

(b) section 8 of the Protection of Depositors, Companies and Prevention of Fraud (Bailiwick of Guernsey) Law, 1969, as amended, which controls the use of the word "insurance" or any cognate expression;

(c) the Protected Cell Companies Ordinance, 1997 which was introduced mainly to facilitate rent-a-captives; and

(d) the Insurance Business (Financial Guarantee Insurance: Special Provisions) (Guernsey) Law, 1996 (and the Financial Guarantee Insurance (Peak International Limited) Ordinance, 1997). This legislation permits the establishment of financial guarantee insurance companies. A guarantee from a financial guarantee insurer provides comfort to bond-holders that they will receive scheduled principal and interest payments should the bond-issuer default.

### 8.3 Resources

The Insurance Division comprises one director, three senior managers, three analysts, one trainee analyst and two secretarial support staff. The Division also utilises the resources available within the Director General's Division.

In addition the Division utilises the services of consulting actuaries to provide advice and review actuarial work prepared by actuaries acting on behalf of Guernsey insurance companies. This review includes checking documentation concerning new products and analysing the actuarial reports which are submitted with the annual returns regarding, inter alia, the sufficiency of reserves. Legal advisers are employed or utilised on an ad hoc basis together with, in May and June each year, a temporary insurance accountant.

### 8.4 Enforcement

The IBL contains similar enforcement powers to those available under the BSL. In addition:

(a) section 26 of the Protected Cell Companies Ordinance, 1997 allows the Commission to make regulations and impose any conditions considered desirable; and

(b) the Insurance Business (Financial Guarantee Insurance: Special Provisions) (Guernsey) Law, 1996 contains powers to wind up, strike off, transfer policies and make administration orders in connection with financial guarantee insurers.

### 8.5 Authorisation and registration requirements

There are three main aspects to any application for registration (insurers) or authorisation (insurance managers):

(a) ownership and management must meet fit and proper considerations and the Commission's policy of selectivity. In addition, insurance managers must have the necessary insurance and administrative expertise;

(b) the business plan must be commercially viable and prudent.

The business plan is a vital part of the supervisory system of insurance business in Guernsey. The IBL, inter alia, requires the general representative (who is normally the insurance manager) to certify that, subject to exceptions or qualifications outlined in the certificate, the insurer has during the period of the Return carried on its insurance

business in accordance with its application, including the business plan, amended as may be necessary. The business plan is required to be a summary of the present and proposed operations of the insurer and is likely to include some or all of the following information:

(i) classes and source of business;

(ii) front (ceding) company, limits and premiums (provide accounts if appropriate);

(iii) deductible/excess/retention;

(iv) reinsurer/s names limits and premiums (provide accounts if appropriate);

(v) stop loss or excess protection;

(vi) types of policies (standard, claims made/occurrence);

(vii) past history of book/s of business;

(viii) feasibility study and three year projections;

(ix) names of any intermediaries involved;

(x) progression of gross premiums to earned premiums (details of the deductions from gross premiums such as reinsurance costs and commissions);

(xi) financial investment (including related party loans) and dividend policies;

(xii) proportion of unrelated business;

(xiii) underwriting guidelines;

(xiv) commission structure (details of commissions payable, including the amount and to whom payable); and

(xv) marketing strategy.

*(c) the application must bring present or potential economic benefit to Guernsey.*

An insurance operation or insurance management operation should also contribute materially to the economic well-being of the Island. However, prudential supervisory issues will always take precedence over the economic benefit.

### 8.6 Authorisation and registration criteria and procedures

The Commission, when considering authorisations and registrations, typically concentrates on:

(i) the vetting of owners, including appraisal of their business plans;

(ii) capitalisation and solvency requirements;

(iii) supervision of insurance reserves; and

(iv) submission of annual insurance returns.

The insurance manager arranges for all aspects of formation, including presentation of the application for approval and recommendations (if required) on local auditors, lawyers, actuaries (if necessary) and local directors.

The starting point for any new insurance company is a full rationale of the reasons why the business should come to

Guernsey followed by a detailed feasibility study. A new company seeking to operate in Guernsey must file a detailed application including a business plan (see above). Applications are carefully scrutinised and, if there are no problems, formation can be a relatively rapid process because the pattern of supervision permits a swift response, especially as the Insurance Division is in regular contact with the insurance management companies.

The application review by the Commission includes:

(i) assessing the validity of the application;

(ii) checking the incorporation documentation;

(iii) vetting owners and shareholders, directors etc and obtaining the audited accounts of the parent company;

(iv) money laundering and fund origination checks;

(v) approval of the appointed general representative;

(vi) approval of the auditors and obtaining evidence of their agreement to act;

(vii) confirmation and approval of the use of actuaries, intermediaries and other related parties;

(viii) checking the accounting methods to be employed;

(ix) a detailed analysis of the business plan including: fronting insurers, reinsurers, nature and type of business, captive retention, funds available, solvency requirements, and the adequacy of the financial projections provided; and

(x) confirmation and approval of where the insurance companies funds will be deposited.

If an application is approved the company will be registered and a certificate issued. In addition, standard conditions are automatically imposed soon after registration on all registered insurers:

(i) any material changes in the information given in the original application for registration, including the business plan, are subject to prior notification to the Commission;

(ii) prior written consent must be given by the Commission whenever changes in the ultimate beneficial ownership or changes in directors or managers are proposed; and

(iii) the company may only write insurance business which conforms with information contained within its current business plan.

The fourth condition applies to life companies only:

(iv) the company must not deliberately mismatch assets against liabilities unless a mismatching reserve is also set up.

In addition, a fifth condition applies to protected cell companies:

(v) the minimum margin of solvency requirements should be calculated on a cellular basis and the surplus in the non-cellular section applied against any deficit in the cells. If there is any remaining deficit in any cell(s) after the above application then funds should be brought into either the non-cellular section or the cell(s) with the remaining deficit.

Specific conditions may be imposed from time to time if circumstances so warrant. (See chapter 17.)

If an application is approved, authorisation is granted and a registration certificate issued. There are two categories of authorised insurance managers: restricted and unrestricted. A restricted authorisation allows the applicant to act in Guernsey as an insurance manager only in respect of the insurer or insurers specified in the authorisation. A restricted authorisation is issued, for example, where the applicant has limited insurance expertise, ie in a specific area of insurance.

It is estimated that each year approximately ten proposals to establish domestic or offshore insurance companies or insurance company managers are encouraged not to make formal applications to the Commission on the basis that formal applications would be refused. In addition, since the introduction of the IBL, the following formal applications have been refused by the Commission or were withdrawn at the Commission's request:

| *Type of insurer* | *Number refused or withdrawn* |
|---|---|
| Domestic | 5 |
| Offshore | 7 |
| Insurance company manager | 5 |
| TOTAL | 17 |

**8.7 General representative**

*(a) Authorisation of general representative*

All registered insurers are required to appoint a general representative who is a fit and proper local resident or an authorised insurance manager. Guernsey's fit and proper requirements are similar to the United Kingdom and normally require a detailed six page questionnaire submitted for each director, controller and manager of the company. If the individual is "known", such as a director of a substantial United Kingdom public limited company, only a CV is required.

Insurance managers are either owned by insurers or reinsurers, brokers or are independent. Most of the top world-wide insurance brokers are now represented in Guernsey. There are few insurance or reinsurance owned managers in Guernsey (or world-wide) and any development in this area would depend upon the calibre of the insurer or reinsurer.

In assessing an insurance manager application the Insurance Division makes checks, inter alia, with respect to the following:

(i) whether the applicant is fit and proper;

(ii) whether the applicant possesses the necessary insurance and administrative expertise;

(iii) the incorporation documentation;

(iv) the audited accounts of the parent company;

(v) that the applicant possesses the necessary professional indemnity insurance and employee fidelity insurance to cover the activity as an insurance manager;

(vi) that the proposed auditors are acceptable and obtain evidence of their agreement to act; and

(vii) details of the services the applicant is proposing to offer.

*(b) Functions of the general representative*

The general representative is responsible for providing:

(i) underwriting expertise;

(ii) development and maintenance of suitable programmes of insurance and reinsurance (ie the business plan) to be accepted and/or ceded;

(iii) drafting and issuing of policy wordings and of all other documentation;

(iv) establishing loss and unearned premium reserves;

(v) claims handling and settlement, including appointment of adjusters where necessary;

(vi) regular and comprehensive management reporting;

(vii) arranging company incorporation and insurance registration;

(viii) provision of registered office and boardroom facilities;

(ix) company secretarial services;

(x) introductions to appropriately qualified locally resident directors;

(xi) supervision of bank accounts and investments;

(xii) maintenance of accounting, insurance and all other corporate records; and

(xiii) preparation of statutory accounts and insurance returns.

Authorised insurance managers normally operate on a contractual basis under a formal management agreement. Such an agreement sets out the extent of the services (which may include some or all of those listed above) and defines the degree of autonomy permitted by and reporting requirements of the Board of the insurance company. It also addresses the provisions of professional indemnity and fidelity protection.

The authorised insurance manager is required to act as general representative to the captive. As such he has certain responsibilities to the Commission. One such responsibility is that any material changes to either the business plan or the application must be conveyed, prior to that change, to the Commission.

It is important therefore that the Board of directors controls the affairs of the company, delegating the rle of managing director or chief executive officer to the authorised insurance manager.

### 8.8 On-going supervisors' requirements: pro-active and reactive

*(a) Captive insurance*

The supervision of the general (local) representative is the key to the supervisory process in Guernsey. This is achieved through regularly meeting with the general representative. This method of supervision is specifically designed so that the Insurance Division is kept updated with any proposed material changes to the business of the insurer and, where the Division is not content, it will advise the general representative accordingly to prevent any such change being made. In addition, on-site visits are made to insurers when considered appropriate.

A detailed annual insurance return, including a new business plan is required each year. Each captive is reviewed at least annually and at each business plan change to ensure that its insurance and reinsurance programme remains properly structured and funded.

Ongoing supervision is aided by regular meetings with the general representative and circulars to the industry. Examples of the subject matter covered in the most recent circulars are: solvency issues, in particular, the treatment of loans to parent companies; accounting issues, such as mortgage indemnity business and the introduction of equalisation reserves; and administrative issues, such as bank mandate structures.

*(b) Offshore life and pensions*

Guernsey's supervision of offshore life and pensions insurers meets the requirements for designation under section 130 of the United Kingdom Financial Services Act by the Secretary of State for Trade and Industry. With respect to policyholder protection, at least 90% of the assets backing policyholder liabilities are required to be held in trust by an independent trustee.

Recently, Guernsey's system of policyholder protection has been amended to allow for approved overseas independent custodians. This change was made because of the limited availability in Guernsey of truly global custodians. In order to accommodate this change, the duties of trustees and custodians have been separated and trustees must all be Guernsey supervised/regulated bodies.

A Pensions Steering Group has been formed in order to consider whether the supervision of pensions is appropriate and, if appropriate, the level of supervision required.

In Guernsey, pension products written under trust have to be approved by the Income Tax Authority. Where products are offered by insurance companies, the Commission supervises the company in such matters as solvency and the insurance company actuary is required to certify that the products are financially sound. Where products are offered by United Kingdom insurers the solvency of the companies is supervised by the Insurance Directorate of H.M. Treasury. The Commission does not, therefore, supervise the pension product itself. The Guernsey Income Tax Authority imposes rules on the setting up of pensions, both personal and occupational.

The selling and marketing of pensions by insurance intermediaries however, will be supervised from 1 January 1999 under the intermediary requirements implemented under the IBL in mid-1998 (see below).

Further information on pension products can be found in chapter 3.

*(c) Other types of insurance entities*

Insurance intermediaries (insurance brokers, agents, consultants) are not currently supervised by any legislation although the States (Parliament) of Guernsey has recently passed legislation which entails the direct or indirect (in the case of agents) supervision of intermediaries from 1 January 1999.

Other changes to the IBL in 1998 mean that those insurers with a direct or indirect physical presence have to register with the Commission and be supervised as regards their market conduct in Guernsey. (Those without a physical presence will be recognized by the Commission and will not need to be registered.) The legislation also provides for a registration procedure for insurance brokers placing business in Guernsey. Insurance agents are not able to carry on business in the Bailiwick unless their principals take responsibility for their actions. All local insurance intermediaries will have to place business with registered or recognized insurers. In order for this to be effective the legislation provides for the registration of friendly societies and European Union insurers.

### 8.9 Solvency margin/reserve requirements, including valuation basis

Minimum capital and solvency requirements are laid down in the IBL but the Commission requires increased levels in most cases. Most insurers in practice have capital and solvency substantially in excess of the minimum requirements.

The minimum level of paid-up share capital, which must be maintained at all times, is 100,000 or an equivalent sum in any other acceptable currency. Irrevocable letters of credit issued by a locally registered bank may exceptionally be used to support the margin of solvency and consequent additional premium income levels.

The minimum level of share capital and the minimum margin of solvency requirement may be waived if the policyholders are jointly and severally liable to discharge all of the liabilities of the insurer.

For an insurer to operate as a going concern it must have total assets which exceed its total liabilities. The excess of total assets over total liabilities is known as the margin of solvency. For the purposes of prudent supervision, insurance legislation in most jurisdictions prescribes minimum levels for the margin of solvency, usually based as a percentage of the net premiums written by the insurer. The IBL contains the following minimum requirements.

> (a) 18% of the first 5,000,000 of net premium income in respect of general business and 16% of the excess above 5,000,000 of net premium income; and

(b) for long-term business (except pure unit-linked), the greater of 50,000 or 2.5% of the value of the long-term insurance fund.

Related party balances, such as deposits with parent companies, are not approved assets unless specifically approved in writing by the Commission.

**8.10 The risk-based approach to supervision**

In all cases the Insurance Division supervises on a risk basis. As well as maintaining the minimum margin of solvency, the insurer must ensure that the funds available are sufficient to meet the total annual aggregate net risk retention together with any forecasted annual expenses. Any risk gap is required to be proven to be adequately covered by way of explanations of the underwriting policies of the insurer. Account is taken of the mixture of the nature of the classes of business involved, the historic and industry based claims experiences and the risk management expertise of the insured. The Division seeks to ensure that the funds available to the insurer are sufficient to meet future years' claims on a worst case basis.

**8.11 Valuation of assets and liabilities**

The value of an asset is its market value or, if no such value is ascertainable, value is determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurers.

The amount of any liabilities of an insurer is determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurers.

The value of any assets of the fund required to be maintained by a registered unit-linked insurer which are matched by long-term liabilities in respect of maturity dates, and which fall within any of the descriptions of approved assets, may be taken to be their maturity value if that value is assigned to them in the accounts and considered appropriate by the auditor.

If the Commission consents in writing, the assets and liabilities of an insurer may be taken to include all those assets and liabilities disclosed by group accounts dealing with the state of affairs and the profit or loss of the insurer, and any subsidiary of the insurer which is a Guernsey company not engaged in trading other than by dealing in investments.

**8.12 Permitted asset holdings**

As with the Division's approach to many other parts of the IBL, the section on approved assets is regarded as a minimum standard. In practice the assets are supervised in a much stricter manner following the principles that:

(a) the liabilities must be matched by appropriate assets having the necessary liquidity;

(b) all asset risks must be identified and regard taken of those risks;

(c) there must be an adequate spread of assets;

(d) the institutions issuing and or holding the assets should be first class;

(e) any debtors outstanding over three months may not be classed as approved; and

(f) particular care is taken regarding related party transactions.

**8.13 Approved assets**

The IBL states that:

(a) when calculating the margin of solvency of an insurer writing general business, at least 75% of the total assets must be approved assets (see below);

(b) an insurer writing long-term business must have at least 25% of the total assets contributed as approved assets, except for unit-linked business where there is no minimum requirement, although that part of the premium relating to the whole of life element attracts a minimum solvency margin as outlined earlier;

(c) For the purposes of the IBL approved assets are:

(i) cash in hand and on deposit with banks;

(ii) certificates on deposit issued by banks;

(iii) eurobonds rated BBB and above;

(iv) securities quoted on a recognized stock exchange;

(v) net investment income receivable in relation to the assets mentioned in items (i), (ii), (iii) and (iv) above;

(vi) premiums receivable;

(vii) reinsurance balances receivable;

(viii) accounts receivable, net of provision for bad and doubtful debts; and

(ix) irrevocable letters of credit provided by a bank registered under the BSL;

An amount receivable or balance due from a person with whom an insurer is associated is not an approved asset of that insurer unless, in any particular case, the Commission consents in writing to it being regarded as such.

**8.14 Submission of annual accounts and auditing**

In respect of each financial year and within four months of its financial year-end the registered insurer must submit the following documents to the Commission:

(a) audited accounts (financial statements) prepared in accordance with the standard accounting practices or the generally accepted accounting principles of the United Kingdom, United States of America, Canada or any other approved practices or principles;

(b) the margin of solvency calculation;

(c) a certificate from the general representative declaring that the insurer has carried on its insurance business plan, as amended during the period, and that the minimum margin of solvency has been maintained throughout that period;

(d) a new business plan;

(e) supplementary accounting information; and

(f) an actuarial report and product/fund actuarial certificates in respect of life companies.

Registered offshore life insurers are required to report quarterly to the Commission. Reports take the form of a set of management accounts and the Insurance Division reviews the volumes of premium income; the level of the insurer's reserves; assets; expenses; and the amounts in trustee/custodianship. In addition, the Commission may request production of a letter of comfort from the parent company and information from the auditors (for example, where the Commission wishes to seek confirmation of the pricing method adopted for units or for the purposes of periodic investigations).

Furthermore, the actuary must provide an actuary's declaration with the company's annual return confirming that he has seen

all the product literature, specimen policy documents and specimen quotations and is satisfied that they do not contain any unreasonable claims in relation to the products or funds described therein. The actuary is also required to confirm the terms on which the products or funds are available and that, having regard to the financial circumstances of the company and the reasonable expectations of policyholders or potential policyholders, he approves of the availability of the products or funds on such terms.

An actuarial declaration also has to be supplied to the Commission in advance of any new product or fund launch.

**8.15 Duties of external auditors**

Duties of external auditors include investigations into:

(a) the systems, in order to ensure that mismatching of assets against liabilities is minimised;

(b) the systems, in order to ensure that the administration adequately monitors the breakdown of expenses on a regular basis;

(c) the systems of reserving and transferring assets to and from custodian/trusteeship on a day-to-day basis. Also required, accompanying the annual insurance return, is a copy of the management letter (including the letter of weakness) from the auditor to the insurer; and

(d) it is emphasised that there is a need for the auditor to satisfy himself of the continuing suitability of the pricing method adopted for units and of the proper administration arrangements for carrying this out.

The firm of auditors proposed by an insurance company is considered by the Commission as part of the regulation process. Only appropriate auditors may undertake the functions specified in this subsection.

**8.16 Public disclosure requirements**

The insurance legislation was tailored to deal with captives and therefore disclosure only covers domestic insurers and offshore life insurers. Additionally, a registered insurer which carries on domestic business must make available, on request to all policyholders of the insurer, copies of the audited accounts. The audited accounts may be made available in an abridged form approved by the Commission.

A registered insurer which carries on long-term business must, not later than one month after the close of the period within which the actuarial report is required to be deposited with the Commission, make copies of that report (or of a report in abridged form and containing such information as the Commission may approve) available to all policyholders of the insurer.

Public information available under the companies legislation is the nominal and issued share capital, the registered office, the names and addresses of directors, secretary and shareholders. Accounts of companies are not filed for public record but must be produced if requested by the shareholders and in the case of resident companies, to the Guernsey Income Tax Authority to support its tax return. The accounts of insurance companies are also required to be audited.

**8.17 Separation of assets and liabilities for life business**

Where a registered insurer carries on long-term business the receipts of that business are required to be entered into a separate account maintained for that business and formed into a separate insurance fund with an appropriate name.

A registered insurer which carries on long-term business must maintain such accounting and other records as are necessary for identifying:

(i) the assets representing the fund maintained by the insurer and each part of that fund; and

(ii) the liabilities attributable to that business and to each part of that business.

It is permissible for protected cell companies to be "composites".

**8.18 Requirements for actuarial investigations**

A registered insurer which carries on long-term business must:

(i) cause an investigation to be made into the financial condition of the insurer annually by the appointed actuary;

(ii) deposit the actuary's report with the Commission together with the audited accounts; and

(iii) not later than one month after the date of the annual return make copies of that report (or of a report in abridged form and containing such information as the Committee may approve) available to all policyholders of the insurer.

The actuarial report must include a valuation of the liabilities of the insurer attributable to the long-term business of the insurer.

The Commission, in certain instances, asks for actuarial reports from insurers other than those writing life insurance business. These instances are where those insurers write liability business where the reserving is material and subjective and those with long-tail portfolio transfers into the insurer. Examples include: all those insurers writing mortgage indemnity guarantee business; the specialist aviation insurers; and those writing nuclear or asbestosis lines.

Actuarial reports are required for all life insurance companies in Guernsey and are of a continuous nature and specifically deal with the following:

(i) adequacy and security of reassurance;

(ii) proper reserving for death and other guarantees including maturity guarantees;

(iii) the investigation of investment linkages presenting potential problems regarding a true valuation of the assets of liquidity problems (eg property funds);

(iv) linkages which cannot be exactly matched (eg to external indices);

(v) options against the insurer that might cause problems and how they are covered, for example, guarantees of surrender values, annuity rates or extended insurability;

(vi) the possibility of a potential new business strain;

(vii) adequate deductions to ensure that early surrenders and paid-up policies are self supporting;

(viii) testing of the effects of closing the company to new business, where appropriate; and

(ix) profit testing of particular products.

**8.19 Supervisors' powers to intervene**

*(a) Investigations*

The Commission may require any registered insurer or any authorised insurance manager to furnish it, on any occasion or at specified times or intervals, with such information as it may reasonably require about any specified matter relating to a registered insurer.

A requirement to furnish information may be imposed on a particular registered insurer or authorised insurance manager, on all registered insurers or authorised insurance managers or on any class of registered insurers or authorised insurance managers.

The Commission can require a registered insurer or an authorised insurance manager to produce, at such time and place as the Committee may specify, any books or papers relating to a registered insurer or authorise any person, on producing (if required to do so) evidence of his authority, to require a registered insurer or authorised insurance manager to produce to him forthwith any books or papers relating to a registered insurer. The Commission has utilised the latter power.

*(b) Intervention*

The Commission may, at any time on or after the registration of any body, impose any conditions which appear to be necessary or desirable. (See chapter 17.)

*(c) Cancellation of registration*

The Commission may cancel the registration of an insurer:

(i) if the insurer or the insurer's general representative has failed to satisfy an obligation of the Law;

(ii) if the insurer has contravened or failed to comply with a condition of registration;

(iii) if the insurer has not commenced insurance business within one year of the date of the registration of the insurer;

(iv) if the insurer has ceased to carry on insurance business in Guernsey;

(v) if the insurer or the insurer's general representative has furnished misleading or inaccurate information;

(vi) if the Commission considers it desirable to cancel the registration of the insurer for the protection of policyholders or potential policyholders of the insurer; and

(vii) on any other ground which may be prescribed.

*(d) Winding up*

The Commission may present a petition for winding up on the grounds: that the insurer is unable to pay its debts or that the insurer has failed to satisfy an obligation (including not submitting audited accounts and/or an actuarial report) of the IBL. A registered insurer which carries on long-term business cannot be wound up voluntarily. Any liquidator of a life company must, unless the Ordinary Court otherwise orders, carry on the long-term business of the insurer with a view to its being transferred as a going concern to another body, whether an existing body or a body formed for that purpose. In carrying out that business, the liquidator may agree to the variation of any contracts of insurance in existence when the Act of Court ordering the winding up is made, but must not effect any new contracts of insurance.

**8.20 Frequency of liquidator or rehabilitation appointments**

There is no rehabilitation procedure in Guernsey except through the protected cell company and financial guarantee insurance legislation where administrators and receivers (of PCCs only) may be appointed before liquidation proceedings commence.

There has only been one case of compulsory liquidation of an insurance company.

**8.21 Links with United Kingdom regulators Exchanges of information Memoranda of Understanding International bodies and conventions**

The Director of Insurance meets with the Insurance Directorate of the Treasury at least five times each year at the

International Association of Insurance Supervisors ("IAIS") Technical, Emerging Markets and other sub-committee meetings and there is an annual meeting to discuss the Financial Services Act section 130 designation. They also meet whenever necessary on specific supervisory issues (eg a life group with operations in the United Kingdom and Guernsey which has outsourced various functions).

Information has always been exchanged under the existing gateways in section 21 of the Financial Services Commission (Bailiwick of Guernsey) Law, 1987. In addition, the Commission is a signatory to the Memorandum of Understanding of the IAIS, as are most members of the IAIS.

Guernsey is a member of the Executive Committee of the International Association of Insurance Supervisors. The Executive Committee consists of the supervisors from Canada (Chairman), USA (Vice-Chairman), Australia, Austria, Chile, Denmark, France, Guernsey, Mexico, Poland, Singapore, South Africa, Sweden and Switzerland.

The early objectives of the IAIS were to facilitate communication and exchange of information between insurance supervisors. Today, the IAIS is involved in many different facets of supervision/regulation, including education, fraud, insurance laws and supervisory regulatory practices and standards, financial conglomerates and derivatives, as well as the original exchange of information objective.

Until October 1996, the Director of Insurance was Chairman of the Education Committee of IAIS and Guernsey hosted this Committee (France, Germany, Hungary and Russia, together with officials from the United Nations and the United States) in May 1996. During this period the Committee brought out a training manual for supervisory staff which was presented to IAIS members in October 1996. The Director of Insurance has subsequently resigned as Chairman of the Education Committee in order to take over the Chair of the newly formed Insurance Fraud Committee.

The Director of the Insurance Division and the Senior Adviser were heavily involved in the formation of the IAIS. The IAIS has now established its own secretariat in Basle, Switzerland.

The Director of Insurance is the current chair of The Offshore Group of Insurance Supervisors which was founded in Guernsey in 1993. It was formed to bring together the offshore insurance supervisors which have established proper, effective supervision: to develop equivalence and acceptable standards; to provide other insurance supervisors with mutual assistance; and to encourage other territories to meet equivalent standards. Working conferences are held annually in order to discuss technical aspects of supervision.

It is the policy of the senior members of the Insurance Division to engage in the widest possible supervisory contact at an international level through giving presentations or participating in discussion. In addition to the international supervisory activities mentioned above, members of the Insurance Division gave presentations or engaged in discussion with the European Commission, the United Nations, the International Association of Insurance Fraud Agencies, other Associations, conferences and insurance (and other) supervisors in Hungary, Luxembourg, the United Kingdom and the United States of America. Members of the Division also make foreign fact-finding visits to supervisors in other countries.

**8.22 Accreditation and reviews**

As mentioned earlier, in 1988 Guernsey was granted designation by the United Kingdom Secretary of State for Trade and Industry under section 130 of the Financial Services Act. In 1996, Guernsey was evaluated by the Offshore Group of Insurance Supervisors' Evaluation Committee and was judged to have met the four criteria of membership which are:

(i) acceptable insurance legislation;

(ii) effective enforcement of the pertinent insurance law;

(iii) adequate resources (including properly qualified supervisory personnel) to effectively administer the supervisory and regulatory functions; and

(iv) the ability to exchange information with other comparable authorities to be used solely for prudential regulation.

Since 1996 an additional criterion of membership has been introduced. Members of the Offshore Group must also have a

clear commitment to the implementation of the anti-money laundering recommendations of the G7 Financial Action Task Force. Guernsey meets this criterion.

### 8.23 Policyholder protection

As mentioned under "Offshore life and pensions above", offshore life companies are required to keep 90% of their assets (which represent the policyholder liabilities) with an independent trustee and in custody.

### 8.24 Passporting

Passporting is European Union terminology and is, therefore, not applicable in Guernsey.

# 9 COMPANIES AND DIRECTORS

Guernsey and Alderney have separate, though broadly similar, legislation concerning the formation, incorporation and conduct of companies. The Guernsey Financial Services Commission ("the Commission") services both regimes.

### 9.1 Types of company

Companies may be incorporated in the Bailiwick in the following forms:

(a) companies limited by shares (Guernsey and Alderney) (however, protected cell companies may only be formed in Guernsey);

(b) companies limited by guarantee (Guernsey and Alderney); and

(c) companies limited by guarantee and shares.

Companies limited by shares are formed under the Companies (Guernsey) Law, 1994 and the Companies (Alderney) Law, 1994. (Protected cell companies are formed in Guernsey under the Protected Cell Companies Ordinance, 1997.) The legislation which enables companies limited by guarantee and by guarantee and shares to be established in Guernsey is the Guarantee Companies Ordinance, 1997, while the Companies (Alderney) Law, 1994 permits the formation of Alderney companies limited by guarantee or by guarantee and shares.

Sark does not possess its own company legislation.

Local company administrators also provide management and director services for companies registered in other jurisdictions.

These facilities reflect the wide experience available locally for handling companies and the provision of general services by local company administrators. There is no requirement to notify the Guernsey authorities of these companies unless their activities fall to be considered within the Commission's statutory functions, or unless they are applying for exempt tax status.

### 9.2 Registered/incorporated companies, Responsibility for "licensing and regulation"

In Guernsey application is made to the Royal Court for authorisation to register a company's memorandum and articles of association. The company is incorporated when the company's memorandum and articles are registered in the Register of Companies maintained by Her Majesty's Greffier who is the Registrar of Companies and issues the certificate of registration. In Alderney application is made to the Clerk of the Court of Alderney acting as Registrar of Companies. The memorandum and articles of association together with the other information required by statute are submitted directly to him. The company is incorporated upon registration of the memorandum and articles. In both Islands it is a requirement that the registrar is notified of the registered office of the company. Application for registration can only be made by an Advocate of the Royal Court of Guernsey.

It is not possible to register a company in Sark as it has no company law.

An application for the registration of any Guernsey or Alderney company (irrespective of whether it is proposed to be an income tax/resident company, an "exempt" company or an international company ("IC")) must be submitted to the Commission by an Advocate who will have completed due diligence checks before submitting the application. Such checks include those specified in the Guidance Notes on the Prevention of Money Laundering.

Application to the Commission (acting on behalf of the Advisory and Finance Committee) under the Control of Borrowing legislation ("COB") for consent to issue founder shares in a Bailiwick company is a pre-requisite of registration for Guernsey and Alderney companies. Commission staff (typically those in the Director General's Division) scrutinise the information provided in the application form for registration and give consent provided that the individuals involved in a company and the activities to be undertaken are acceptable. However, it should be noted that cover is provided by staff in the other Divisions in order to ensure a spread of knowledge around the Commission and to tap the expertise of the specialist areas of the supporting staff. In addition, all potential companies intending to conduct financial services activity are referred to the relevant Division or the Director General as appropriate. Approximately 50 applications to form companies are refused each year by the Commission and others are discouraged before they apply. In addition, the proposed beneficial owners of a number of other companies decide not to utilise Guernsey as a jurisdiction for company registration/ incorporation when the Commission reverts with queries on the completed application form. Once provisional consent has been granted under COB a copy of the formation papers is submitted to the Law Officers of the Crown for their approval which is necessary before application can be made for registration in Guernsey or Alderney.

The Law Officers review the form submitted to and approved by the Commission. They consider that part of the form where a declaration is made as to whether the company's formation will enable any person to avoid any existing liability to United Kingdom income tax, corporation tax or capital gains tax, or an existing potential liability to United Kingdom death duties.

The Law Officers also avail themselves of the opportunity to draw to the attention of the Commission any information possessed by the Law Officers which may provide a reason why the company should not be incorporated. From time to time, provisional consent under COB is withdrawn at this stage. The application to form the company is refused by the Commission.

The dual approval system is an effective one which has a deterrent objective and also enables close scrutiny to be given by both regulators and Law Officers.

If no difficulties arise from the Law Officers' or the Commission's consideration of the formation papers the company may proceed to the next stage in the registration procedure. If there are difficulties, the Law Officers will not provide the documentation necessary to enable the application to proceed to the Royal Court or (in Alderney) to the Clerk of the Court. The system works effectively and on a preventative basis.

In Guernsey no distinction is made between public and private companies at present but it is possible that a distinction may be made in a future companies law. The current thinking is that a company will be considered to be a public company if, regardless of how many shareholders it has, it regards itself as a public company and accepts the requirements appropriate to such a company. A company which offered its shares for sale to the public or sought a quotation on a recognized exchange would be making such an election. However, Alderney company law does differentiate between public and private companies. Public companies include those with more than 20 members or those with memoranda which state they are public companies. Applications to form Alderney companies do not specify whether or not they are public companies. However, the application papers for all company formations state whether or not any shares in the company are to be issued to the public. Where shares are to be so issued consideration is given as to whether any of the Bailiwick's supervisory/regulatory legislation is applicable. Even if it is not applicable the Commission requires sight of prospectuses and other information in order to ensure that the proposed public shareholders have sufficient information to form a reasonable judgement on whether or not to buy the company's shares and so that the Commission has sufficient information on which to form a judgement on whether or not to permit the company to be formed.

As mentioned above, consent under COB is required for the issue of a company's founder shares. The other "hurdles" depend upon the nature of the business to be undertaken by the company. For example, an institution proposing to carry on banking, fiduciary, insurance or investment business will require scrutiny by the relevant division of the Commission and in practice this scrutiny is completed before a company is permitted to be formed. There is no requirement for a person to have a housing licence or to be a Bailiwick resident in order to beneficially own a Guernsey or Alderney company.

All companies applying for consent to register/incorporate under COB must disclose the following details which are confidential to the Commission and the Law Officers who, as noted above, must also vet the application for registration:

(a) company name;

(b) beneficial ownership details (such as names, addresses, occupations, dates of birth, places of residence and

places of domicile);

(c) name of the office/person introducing the application;

(d) reason for incorporating in Guernsey;

(e) true objects of the company;

(f) declaration whether any existing United Kingdom tax liabilities will be avoided by the incorporation;

(g) whether any shares are to be issued to the public;

(h) tax status of the company; and

(i) authorised and issued share capital details.

When the company registers at the Greffe (Registry) or the Company Registry in Alderney it is required to disclose details of its registered office, share capital, directors and founder members, as is the case in other jurisdictions. This is publicly available information.

### 9.3 Shelf companies

The Bailiwick does not offer shelf company facilities and there is therefore no avoidance of the obligation to disclose the initial beneficial ownership and other information on the company formation application form to the Commission or the Law Officers.

The authorities in Guernsey take steps to ensure that only bona-fide companies are incorporated in Guernsey and Alderney and that in respect of foreign companies information is obtained in relation to those which seek exempt tax status and those which carry on business in Guernsey.

### 9.4 Tax status, residence test and returns

Descriptions of the three different types of company available in the Bailiwick (income tax companies, "exempt" companies and international companies) and the residence test for income tax companies are provided in chapter 3 of this report. The collection of tax and the enforcement of the taxation legislation is the responsibility of the Income Tax Authority.

### 9.5 Requirement to register

A company which is chargeable to Guernsey tax is required to give notice of the fact to the Administrator of Income Tax. The Income Tax (Guernsey) Law, 1975 ("the Income Tax Law") provides for penalties for failure to do so. However, it is possible for a company which is not registered/incorporated in the Bailiwick to carry on some activities in Guernsey or Alderney without it becoming chargeable to income tax. For example, it may carry out administrative functions which are necessary to comply with company law. It may also carry out some of its own clerical and secretarial functions in Guernsey or Alderney without being taxed, as such activities are not considered, for income tax purposes, to amount to the carrying on of a business.

A non-resident company for tax purposes is liable to tax on all Guernsey and Alderney sources of income other than income derived from Guernsey and Alderney bank deposits or exempt bodies.

As indicated above, a company which is liable to tax is required to give notice of its chargeability (although the comments above regarding certain administrative functions should also be noted) and to submit details of its income to the Income Tax Authority. In the majority of cases accounts will need to be filed, although in some, for example where the only Guernsey and Alderney source income is from a property rental, full accounts will not be requested - only such information as is necessary to determine the company's liability to tax.

Where a person is required to deliver a return under the Income Tax Law, the term "return" includes any list, statement, particulars, accounts or other information which the Income Tax Authority or Administrator may require any person to furnish under the provisions of the Income Tax Law. Part XVIII of the Income Tax Law provides for the imposition of a penalty for failure to deliver a return.

### 9.6 On-going requirements/changes in details

In January of each year every Guernsey and Alderney company is required to file an annual return at the Greffe or the Company Registry in Alderney as appropriate, which record the following details:

(a) registered office;

(b) share capital structure;

(c) names and addresses of directors; and

(d) names and addresses of the shareholders and how many shares each holds.

The file containing the annual returns is open to inspection by the public.

A change of company name needs to be confirmed by an order of the Court. Under the Companies (Guernsey) Law, 1994, the Commission has the power to object to a proposed new name and in practice all proposed company name changes for companies are put to the Commission in advance to ensure that any difficulties are ironed out before reaching the Court. After the Commission has confirmed it has no objection to a proposed change of name, the company is required to give notice of the intended new name to the public on two occasions in the Gazette Officielle (the official gazette publishing various notices required to be made public by law in the island of Guernsey) before the change is sanctioned by the Court. If any person has reasonable grounds for objection to a name they can apply to the Court in order to prevent that body from obtaining the necessary order confirming the change. Similar provisions exist under the Alderney company law in respect of Alderney companies.

"Exempt" companies and ICs are required to notify the Commission of any changes in ownership and the directors or other authorised signatories are required to sign an annual declaration to the Administrator of Income Tax that any such changes have been duly notified. Resident tax status companies are not obliged to disclose changes in ownership to the Commission. However, in practice, most administrators of local companies not only disclose the relevant details but ask for the Commission's consent before effecting any changes in ownership, whatever a company's tax status.

The objects of a company might change over a period of time. The Commission expects to be notified by a company administrator when a change is intended, although there is no obligation to notify unless the proposed new activity is one which is supervised or regulated by the Commission (ie in the field of financial services).

There is no requirement to notify any change in the share structure of a company to the Commission but (with certain exceptions) consent is required under COB when 500,000 or more, or any currency equivalent, is to be raised by the issue of shares in any 12 month period.

There is no requirement to make a public filing of accounts.

As mentioned in chapter three, Guernsey company law requires every company incorporated in the Island, except unaudited companies, to have a qualified auditor as defined by the Companies (Guernsey) Law, 1994. Unaudited company status is only available to dormant or asset-holding companies. An estimated 1%-2% of companies resident for tax purposes have unaudited company status. The Guernsey Income Tax Authority has the power to require certified accounts for the purpose of checking the tax form submitted. Tax exempt companies registered in Guernsey are required to have an auditor unless they are an "unaudited company" as defined - ie. asset-holding or dormant. Each tax exempt company is granted such status on an annual basis and the yearly application provides an opportunity to assess the tax position of such companies. The position is different in Alderney in that Alderney private companies do not need to be audited by a qualified auditor (as defined) if the shareholders have agreed in writing that an audit is not required and the articles do not require the company to appoint auditors. A substantial percentage of the companies registered in Alderney are registered on behalf of Alderney

resident individuals or companies trading in Alderney. Should the finance industry grow significantly in Alderney then that Island's authorities can be relied upon to regulate as may be necessary.

Guernsey and Alderney companies on the respective Registers of Limited Liability Companies have three different tax categories available, depending upon the nature and qualification of the business and beneficial owners: tax resident, tax exempt or international company status:

- resident companies are charged at 20%;
- tax exempt companies pay an annual fee of 600; and
- International companies pay at a rate above zero but no more than 30% accepted by the Administrator of Income Tax.

### 9.7 Insolvency

While there is no general insolvency legislation in the Bailiwick there are, nevertheless, a number of legislative provisions spread over a number of laws and ordinances which are relevant to the concept of insolvency.

A number of these provisions are potentially relevant particularly to financial institutions and products serviced by financial institutions:

(a) the enactment of the Insolvency Act 1986 (Guernsey) Order, 1989 means that section 426 of the United Kingdom Insolvency Act applies to Guernsey. The result of this is that the Courts of the Bailiwick must assist and give orders in aid of the United Kingdom, Jersey and Isle of Man Courts having corresponding insolvency jurisdiction;

(b) the winding up of companies and protected cell companies occurs pursuant to Part XV et seq of the Companies (Guernsey) Law, 1994 which provides for voluntary or compulsory liquidation. There is no provision for the appointment of administrators or receivers, except that under the Protected Cell Companies Ordinance, 1997 it is possible for the Court to make receivership orders for the orderly winding up of the business and affairs of a particular cell and administration orders for the management of the business and affairs of a particular cell with a view to its survival as a going concern. The law of Alderney relating to winding up is set out in the Companies (Alderney) Law, 1994 and is virtually identical to the foregoing powers in the Companies (Guernsey) Law, 1994.

In addition, Guernsey company law provides that an application for the compulsory winding up of a supervised or regulated company will not be heard unless a copy of the application has been served on the Commission not less than seven days before the hearing. The Commission can then make representations to the Court. Also, a company may (on the application of the Advisory and Finance Committee or the Commission on the Committee's behalf) be wound up by the Court, if the Court is of the opinion that it is desirable that the company should be wound up for the protection of the public or of the reputation of the Bailiwick of Guernsey;

(c) there are also provisions in the Companies (Guernsey) Law, 1994 providing for remedies in respect of fraudulent and wrongful trading closely based on sections 213 to 215 of the United Kingdom Insolvency Act 1986. Similar provisions exist under the Alderney (Companies) Law, 1994;

(d) the Preferred Debts (Guernsey) Law, 1983 prescribes which debts are to be accorded priority in a company winding up;

(e) the dissolution of partnerships pursuant to Part V of the Partnerships (Guernsey) Law, 1995; and

(f) the dissolution of limited partnerships pursuant to Part IV of the Limited Partnerships (Guernsey) Law, 1995.

### 9.8 Inspectors

The Alderney (Companies) Law, 1994 provides for the appointment of inspectors. However, it has not been found necessary, in recent times, to appoint inspectors to investigate an Alderney company.

The Court may, on the application of any one or more members holding between them not less than one fifth of the company's issued share capital or the States of Alderney Policy and Finance Committee, if satisfied that there are reasonable grounds, appoint an inspector or inspectors to investigate and prepare a report upon the affairs and financial position of a company.

In addition, an application for the appointment of an inspector or inspectors may be made ex parte to the Chairman of the Court or to any Jurat thereof if the circumstances are such that it is desirable that the appointment should be made as a matter of urgency and before a sitting of the Court can be duly convened.

### 9.9 Locally administered companies incorporated elsewhere

There is no register of foreign companies administered in the Bailiwick but it is estimated that there could be about 20,000 such companies administered in the island of Guernsey.

Such companies are able to apply for exempt tax status. In order to qualify for such status with the Income Tax Authority a company must first notify the Commission of its ownership and objects. If the company is not applying for exempt tax status, there is no requirement to notify the Commission or to register with any of the other local authorities unless the company is carrying out an activity which falls to be considered under the Commission's statutory functions.

Other than applying for exempt tax status, non-Bailiwick companies do not have to notify the Guernsey authorities of their presence unless they trade in the Islands. Non-Bailiwick companies trading in the jurisdiction may be subject to tax on the income arising from that activity.

When a non-Bailiwick company applies for exempt tax status it must notify details of beneficial ownership and activities to the Commission. It is possible that the Commission might object to certain activities or owners and representation might be made to prevent such company being granted exempt status. Any information provided is held in confidence. There is no public register of non-Bailiwick companies administered in the Bailiwick.

### 9.10 Directors

The directors of Guernsey and Alderney companies are required to be fit and proper persons. Schedule 5 to the Companies (Alderney) Law, 1994 and section 67A and Schedule 3 of the Companies (Guernsey) Law, 1994 set out the points to be taken into account when considering whether a director is fit and proper.

In determining whether a person is fit and proper to hold a Guernsey directorship regard shall be had to:

(a) his probity, competence, solvency and soundness of judgement for fulfilling the responsibilities of that position;

(b) the diligence with which he is fulfilling or likely to fulfil those responsibilities;

(c) whether the interests of members or creditors or potential members or creditors of the company are, or are likely to be, in any way threatened by his holding that position; and

(d) the rules, standards and guidelines of any relevant professional, governing, regulatory or supervisory authority.

Without prejudice to the generality of the foregoing provisions, regard may be had to the previous conduct and activities in business or financial matters of the person in question.

The Companies (Alderney) Law, 1994 has the same requirements as the Companies (Guernsey) Law, 1994 with the addition that, in determining whether a person is fit and proper to hold an Alderney company directorship, regard shall also be had to any reports, guidelines and other documents published by the Commission.

In respect of both Guernsey and Alderney companies legislation, Disqualification Orders may be made by the Court in order to prevent a person from acting as a director or officer of a company for up to five years if the Court is satisfied that it is desirable in the public interest to do so. Any person may also be prohibited from participating in, or being in any way

concerned in, the management, formation or promotion of any company. A Disqualification Order may contain such incidental and ancillary terms and conditions as the Court thinks fit.

Such provisions in the Companies (Guernsey) Law, 1994 and the Companies (Alderney) Law, 1994 do not extend to directorships of companies registered/incorporated outside the Bailiwick. However, during discussions of the Fiduciary Business Law Joint Working Party it has been identified that a separate law should be introduced to register those who make a business of acting as a director. It is expected that this will be a Bailiwick-wide law applying to all persons in the Bailiwick holding directorships of all companies, wherever registered/incorporated.

Directors of supervised or regulated companies are subject to close inspection by the Commission and are normally required to complete Personal Questionnaires.

No directors have been disqualified so far under Bailiwick companies legislation but work is currently in hand to bring cases against individuals who have recently been convicted by the Court on charges of dishonesty.

Even where the directors of Guernsey and Alderney companies are deemed to be fit and proper there is provision within the Islands' respective companies legislation for companies to be compulsorily wound up.

Under Guernsey law an application for the compulsory winding up of a company may be made to the Court by the company, by any member or creditor thereof or by any other interested party (which could include the Commission) but as yet this has not been necessary. In respect of supervised/regulated companies or previously supervised/ regulated companies or a company which is of any other class or description prescribed by regulations of the Commission, an application for an Order shall not be heard unless it has been previously submitted to the Commission. In such circumstances the Commission may make representation to the Court.

Under Alderney companies legislation, the States of Alderney Policy and Finance Committee or an interested party (which could include the Commission) may make a similar application compulsorily to wind up an Alderney company.

While there are no companies incorporated in Sark, some residents of Sark have specialised in providing their services to companies incorporated elsewhere. The Commission plays no part in controlling such corporate activity in Sark but has been strongly supportive of the new legislation in the Bailiwick covering "Representation of False Domicile". The law (entitled the False Documents and Domicile, etc (Bailiwick of Guernsey) Law, 1998) came into force in July 1998 and it outlaws the provision of documents which establish false addresses and the false holding out that any person is domiciled or resident in the Bailiwick. This has been an area of activity in Sark which has caused some media comment and as a result of this new legislation it is anticipated that this practice will no longer be able to continue. The other activity in Sark which has caused some difficulty is the practice of certain individuals there holding themselves out as company directors, whilst passing all directors' duties to the owners of the company, thus taking no responsibility for the activities of that company. It is anticipated that this practice will be caught by the proposed Bailiwick-wide legislation on directorships where standards are proposed to be set for company managers and directors; amongst other matters this should ensure that responsibility is taken when an individual registers as a company director. These provisions may be contained in the fiduciary business law or in a stand-alone law.

**9.11 Breakdown of companies/partnerships administered in Guernsey**

| | Registered? | Total number as at January 1998 | New registrations during 1997 |
|---|---|---|---|
| Tax resident Bailiwick companies | Yes | *7695 | not known |
| Tax exempt Bailiwick entities | | | |
| Companies | Yes | 8084 | 888 |
| Collective investment funds** | Yes | 278 | 49 |
| Limited partnerships | Yes | 188 | 30 |
| International business companies - | | | |

| | | | |
|---|---|---|---|
| Bailiwick companies | Yes | 147 | 34 |
| Administered non-Bailiwick companies | No | No 20000 est | not applicable |
| TOTAL OF KNOWN AND ESTIMATED FIGURES | | 36392 | 1001 |

NB: This information has been provided by the States of Guernsey Income Tax Authority and the Guernsey Financial Services Commission.
* number as at 21 April 1998
** the entities mentioned comprise only a proportion of the collective investment funds supervised/regulated by the Commission.

At 1 July 1998 there were twenty protected cell companies comprising nine insurers and 11 collective investment schemes. Of these 20 companies, 17 were tax exempt, two were tax resident and one was an international company.

Limited liability partnerships are not permitted within the Bailiwick and none is established there. No specific figures are available for partnerships but it is estimated that most partnerships established are law and accountancy practices.

# 10 PARTNERSHIPS

### 10.1 Partnerships

Partnerships can be formed in the island of Guernsey under the Partnerships (Guernsey) Law, 1995 which is based on the United Kingdom's Partnership Act 1890. The major international accountancy firms together with a large number of local accountancy firms are represented through partnerships; the local firms of Advocates are similarly formed as partnerships. The partnership legislation does not require a partnership to be registered with the Greffe or the Guernsey Financial Services Commission ("the Commission"), although the Commission takes action when a partnership attempts to conduct supervised or regulated business from the Bailiwick, as was demonstrated in a recent intervention. Any partnership conducting or formed to conduct supervised or regulated business would be treated in a matter identical to any other entity.

### 10.2 Limited partnerships

The Limited Partnerships (Guernsey) Law, 1995 has accounted for the registration in the island of Guernsey of 53 limited partnerships, the majority of which are collective investment fund related vehicles. Such vehicles are supervised/regulated by the Commission no differently to collective investment funds constituted as companies or unit trusts.

Historically, North American investors have used the limited partnership as a pooled investment vehicle, particularly for funds providing private equity capital and venture capital. As a form of business undertaking the limited partnership is not suitable just for collective investment funds. It is considered that some captive insurers would also fit this form well.

Features of the Guernsey limited partnership include:

(i) a minimum of one general partner and one limited partner;

(ii) no restrictions on the number of partners;

(iii) a fixed duration or not, as appropriate but if no fixed duration, limited partnership is dissolved after 30 years;

(iv) accounts may be maintained in any currency; and

(v) tax transparency - the incurring or any liability to tax in the hands of the investors (limited partners) rather than in the hands of the partnership as such.

The formation of a Guernsey limited partnership requires consent from the Commission (acting as the agent of the States Advisory and Finance Committee). Applications for the formation of limited partnerships are provided to the Commission, and treated by the Commission in a similar manner to company applications. In order to register a limited partnership details of it must be filed at the Greffe (Registry). The information which is filed is a public record. Such information will include a copy of the partnership agreement, together with a declaration signed by one or more of the general partners containing the following particulars - the name of the limited partnership, the nature and principal place of its business, and its registered office. The full name of every general partner and his address is also available for public inspection.

In addition, the general partner of a Guernsey limited partnership is often a Bailiwick company and therefore subject to the Commission's review before its incorporation.

### 10.3 Limited liability partnerships

There is no limited liability partnership law in the Bailiwick.

### 10.4 Taxation

Partnerships, including limited partnerships, have no tax status in their own right as, under section 42(1) of the Income Tax (Guernsey) Law, 1975, ("the Income Tax Law"), each partner shall be assessed and charged in respect of his share of the profits of the partnership.

In light of this the Income Tax Authority distinguishes between the general partner and the limited partners in a limited partnership arrangement as, under the Income Tax Law, they are dealt with quite differently (the general partner carries on the business/performs the activities of the limited partnership whereas a limited partner's rle (as an investor) is a passive one).

The Income Tax Law provides that in the case of a non-resident limited partner, any income of the partnership attributable to him which is derived from international operations can be received on a tax free basis. The term "international operations" means business operations conducted on behalf of a limited partnership with, and investments made on behalf of a limited partnership in, persons who are not resident in Guernsey or Alderney for the purposes of the Income Tax Law.

There is no such provision regarding the general partner of a limited partnership, however, and consequently, where the general partner is a Bailiwick company, the general partner will be liable to tax at the 20% rate on its share of the partnership profits, unless (by virtue of its beneficial ownership) it is able to elect for tax exempt or international company tax status.

In practice, limited partnerships tend to derive income wholly from overseas and are beneficially owned by non-residents, the effect of which is that the limited partners have no liability to Guernsey tax whereas the general partner opts for tax exempt status. Guernsey derives income from support services (such as legal, accounting and administration services) provided to the limited partnership and profits from these activities are taxed at the 20% standard rate.

# 11 TRUSTS AND TRUSTEES

### 11.1 Policy

As mentioned in chapter 12, the Guernsey Financial Services Commission ("the Commission") takes a close interest in trustees and corporate and trust service providers.

### 11.2 Main types, purposes, scale and growth

Since there is no register of trusts, there are no specific figures available on the number of trusts established or administered from Guernsey nor the value of assets held in them. A guess would, however, suggest a figure of up to 20 billion. It is not possible to provide a breakdown of the main types of or purpose of trusts other than that described in chapter 3. However, it is known that they are established for the benefit of families, collective investment funds, company employee benefit schemes or specific one-off purposes.

### 11.3 Advantages of offshore trusts

The advantages of using Guernsey trusts are specified in chapter 3.

### 11.4 Taxation

Section 53 of the Income Tax (Guernsey) Law, 1975 ("the Income Tax Law") provides for the liability to tax in respect of trust property.

A trustee may be charged with income tax at the standard rate in respect of any income which he is entitled to receive on behalf of any person or which is derived from property vested in him.

If a trustee who is chargeable submits to the Administrator of Income Tax a return of the total income of the beneficiary from all sources, he may, on behalf of the beneficiary, claim any allowance or relief which the beneficiary could have claimed if he had been charged in his own name.

It is the duty of a trustee who is chargeable under this section of the Income Tax Law to make all returns and to do all such matters and things which the person beneficially entitled to the income would have been required to make or do if he had himself been chargeable in his own name.

### 11.5 Provenance

The Commission is not normally aware of details of settlors and beneficiaries of trusts, although the fiduciary managing a trust is aware of such information. Typically, the identity of settlors and beneficiaries is only known by the Commission when they are named as beneficial owners of a Guernsey company.

It is not known what the precise geographical breakdown of settlors and beneficiaries is other than to say that it is a completely global business, as indicated by the table in chapter 3 which compares trust business originating in the United Kingdom with that originating in the rest of the world. A survey held in 1996 found that nearly three-quarters of the total value of assets held by trusts administered in Guernsey were for the account of clients outside the United Kingdom. The

Commission considers that over 80% of the total value of assets held by such trusts are now for the account of non-United Kingdom clients.

### 11.6 Legislation

The duties and responsibilities of Guernsey trustees are covered by the Trusts (Guernsey) Law, 1989, as amended. The island of Guernsey is covered by the Hague Convention on the recognition of trusts. Alderney and Sark do not possess their own trust legislation but trusts administered in those islands stipulate the jurisdictional law under which they are governed.

### 11.7 Registration and "regulation"

As in the United Kingdom, there is no register of trusts in Guernsey and none is planned. It should be noted that the Commission supervises or regulates those trusts which are collective investment funds and, additionally, that consent may be required under the Control of Borrowing legislation in certain circumstances such as the raising of money (500,000 or more in any 12 month period) by a trust.

### 11.8 Enforcement

The Commission will be responsible for the formal supervision of providers of fiduciary services once the proposed fiduciary business law comes into force. (chapter 12 refers).

# 12 FIDUCIARIES AND THE PROFESSIONS

### 12.1 Policy

The Commission takes a close interest in fiduciaries (trustees and corporate and trust service providers). Since 1984 there has been an embargo on the formation of new fiduciary businesses with certain exemptions, namely where the application is from a local professional firm, a local bank or an institution found to be otherwise acceptable (eg an overseas bank or a substantial professional firm). The Commission expects fiduciaries to know their customers in line with the Guidance Notes on the Prevention of Money Laundering and to carry out their duties in accordance with company and trust legislation.

Where it appears that a proposed fiduciary operation may fall within one of the exemptions to the 1984 embargo the applicant is required to provide the following information to the Commission:

(a) a business plan;

(b) confirmation of how the "four-eyes" criterion will be satisfied;

(c) details of the proposed beneficial ownership;

(d) the proposed level of professional indemnity insurance;

(e) the proposed authorised and issued share capital;

(f) details of the proposed local directors; and

(g) the estimated economic benefit to the Bailiwick.

The information provided is scrutinised by the Director General's Division in conjunction with the other Divisions as necessary. Additional information may be requested. Any consent issued to form a fiduciary may be subject to conditions.

### 12.2 Scale and type of fiduciaries and the professions

While there is no formal register of fiduciaries, it is known that there are at least 130 firms operating in this field, including the administered fiduciaries. Administered fiduciaries operate on the same basis as administered banks. The main owners of fiduciaries are banks and accountancy and legal practices, with the remainder being long-established and in private ownership. Ownership is evenly spread between these categories. It is not possible to give figures on the number which might have less than three professional staff but in view of the "four eyes" principle which the Commission has utilised since 1988 it is unlikely that there are many fiduciaries with three staff or less, although obviously there are some.

### 12.3 Obligation to use

There is no obligation to use a local fiduciary when incorporating a local company or establishing a trust under Guernsey law (only the utilisation of an Advocate is necessary for the registration of a company), although Guernsey and Alderney companies must have a local registered office address.

### 12.4 Proposed approach to supervision

The question of whether and how fiduciaries in the Bailiwick should be supervised has been the subject of much debate and deliberation. The topic has been raised several times, most recently in the context of the proposed extension to the Protection of Investors (Bailiwick of Guernsey) Law, 1987 ("the POI Law"). Respondents to the Commission's consultation paper "Extension of the Protection of Investors Law" issued in February 1996 made it clear that the Commission should be even-handed in the application and scope of the proposed extension. That is to say, if proposed regulation was to bite on investment businesses carrying on similar (if not exactly the same) activities to those of fiduciaries, fiduciaries should also be subject to the POI Law.

Guernsey is one of the first jurisdictions to take pro-active action on the issue of fiduciary oversight and supervision. In this connection a consultation document on the proposed supervision of fiduciary business was published by the Commission in October 1997.

A Fiduciary Business Law Joint Working Group comprising Commission staff and industry practitioners had been established prior to the publication of the consultation document. The Joint Working Group discussed the issues surrounding the supervision of fiduciary business and it does not accept that "fiduciary business" is the same as "investment business". For example, discretionary fund management is a type of investment business where the assets under management belong to the client of that business, whereas, under a trust deed, the trustee is the legal holder of the assets belonging to the trust. Similarly, a company administration business acts on the instructions of the beneficial owner(s) of the companies it administers.

A further distinction is that the POI Law, under which institutions carrying on investment business are licensed, is designed to protect the interests of individual investors who use the services of those institutions. This is essentially different from the relationship between trust companies and the settlors/beneficiaries of trusts and between company administrators and the companies which they administer. The Joint Working Group recommended that the Commission should reflect this difference in its approach to the supervision of fiduciaries.

The Commission therefore proposes to exempt those conducting solely fiduciary business from the need to obtain a licence under the POI Law and instead to encompass such fiduciary business in new legislation.

The objective of the Commission here is to establish a rgime of supervision for those engaged in fiduciary business. By introducing new legislation with the primary aims listed below, the intention is to ensure a reasonably level playing field for all of the various sectors of finance in the Bailiwick and to maintain and encourage good quality business and clients. The primary reasons for proposing new legislation for the supervision of fiduciaries are:

(i) to protect the reputation of the Bailiwick;

(ii) to deter unscrupulous or criminal abuse of the Islands;

(iii) to deter malpractice and fraud against clients; and

(iv) to encourage high standards of business conduct.

The new legislation should enable the Commission to become the primary focus for overseeing fiduciary business activities.

The Commission's consultation paper indicated a strong preference for a notification system as opposed to a licensing rgime. It was envisaged that in most respects the notification system would closely resemble a conventional licensing system, with the information required to be provided to the Commission at the introduction of the law being the same as that which would be required to support an application for a licence. Since the publication of the consultation paper the Commission has concluded that a conventional licensing system should be developed.

The general provisions of the proposed framework include legislation, a system of licensing fiduciary business, vetting of proposed new fiduciary businesses, collection of fees and powers of investigation and enforcement for the Commission, rules and guidance. However, it should be noted that the consultation process is still on-going.

The proposed law, which will be applicable throughout the Bailiwick, is anticipated to contain provisions similar to those in the existing legislation which the Commission administers, ie that the fiduciary business cannot lawfully be carried on by any person unless the Commission is notified that it is being carried on (or it is proposed that it be carried on) and has not

made a prohibition order or made conditions and requirements as it may be entitled to make under the law. A central feature of the law is anticipated to be a clause setting out minimum criteria to be satisfied by a fiduciary in order to be allowed to carry on the business. The consultation document suggested that these could include:

(i) that the business is and continues to be conducted with prudence, professional skill and integrity appropriate to the nature and scale of its activities and in a manner which will not bring the Bailiwick into disrepute as an international finance centre;

(ii) that the business is conducted in a prudent manner, including financial resources and insurance cover commensurate with the nature and scale of the institution's operations, strict separation of client funds and assets from those of the fiduciary, adequate accounting and other records and satisfactory internal controls; and

(iii) that all directors, controllers or managers of company and trust service providers are fit and proper to hold their positions (proposed directors will be required to complete Personal Questionnaires);

(iv) that at least two individuals effectively direct (or will direct) all aspects of the business (the "four-eyes" principle);

(v) that the Bailiwick is deriving (or will derive) economic benefit from the institution's operation; and

(vi) any other factors which the Commission thinks it appropriate to consider.

It is known that some existing fiduciaries do not meet the "four-eyes" test. The Commission's view is that ultimately all fiduciary businesses operating within the Bailiwick must meet the test (ie there will be no absolute grandfathering provision) and that a time limit for this to be achieved (eg one year from the commencement of the law) should be established by transitional provisions. In the same way, consideration could be given to a time limit for meeting a minimum competence level, which as well as academic qualifications and membership of professional bodies, could embrace experience and track record in relevant fiduciary activities.

The Commission intends to make rules (with the force of law) and guidance which will ensure a clear and general understanding of the high standard of business conduct expected. The Commission also anticipates having the power under the new law to make orders prohibiting a person from the carrying on of fiduciary business or of some prescribed type of business or to impose conditions on the carrying on of fiduciary business by a particular person, breach of which would be a serious offence with penalties.

One recommendation of the Joint Working Group is that the Commission should have the power in appropriate circumstances to petition the Court to appoint successor trustees of the underlying trusts. The Commission believes that a similar approach could be adopted in respect of a fiduciary providing pure company administration services. The Commission expects the fiduciary business law to be enacted during 1999.

### 12.5 Lawyers

Lawyers practising in the Bailiwick of Guernsey fall into three general classes:

(i) Advocates of the Royal Court (Advocates);

(ii) lawyers practising in partnership as English solicitors; and

(iii) other lawyers employed otherwise than in private practice.

*(a) Advocates of the Royal Court*

Advocates have a right of audience in the Royal Court and in the other Courts of the Bailiwick. They deal with all types of legal work.

In addition to H.M. Procureur (H.M. Attorney-General) and H.M. Comptroller (H.M. Solicitor-General) there are 72 Advocates. Four are employed in the Chambers of the Law Officers of the Crown where four other qualified lawyers, who

are training as Advocates, are also employed.

Sixty-three Advocates are in full time private practice (61 in Guernsey and two in Alderney). Two are employed in banks, two are in the part-time employment of the States of Guernsey, one is the Registrar of the Ecclesiastical Court and one is no longer in active practice. There are ten firms of Advocates practising in Guernsey. Four of them have three or fewer lawyers. There are two single practitioners in Alderney.

*(b) Lawyers practising in partnership as English solicitors*

There are seven firms of English solicitors practising in the Bailiwick and they employ 12 lawyers. There is only one firm employing three or more solicitors on a full or part-time basis. Some of the firms are branches, or closely associated with law firms operating outside the Bailiwick. They are not qualified to advise on the law of the Bailiwick of Guernsey and are not permitted to draft documents governed by Bailiwick law for reward.

A person may not hold himself out as a solicitor unless recognized by law as being authorised to do so.

*(c) Lawyers employed in other businesses*

Banks, trust companies, accountancy firms and other financial institutions employ English solicitors or barristers. The number of lawyers employed in these businesses is not known.

*(d) Regulation of lawyers*

The professional conduct of Advocates is regulated by the Royal Court. Advocates are subject to the Rules of Professional Conduct sanctioned by the Bailiff. There is a Disciplinary Tribunal. Rules of the Royal Court also regulate how Advocates must deal with monies handled by them, namely:

(i) The Advocates Trust Accounts Rules 1989 governing monies received subject to a trust of which the Advocate is a trustee;

(ii) The Advocates Accounts Rules 1989 governing monies received from clients; and

(iii) The Advocates Accounts (Deposit Interest) Rules 1989 governing the payment of interest held on client account.

English solicitors are regulated by the Law Society and English barristers by the Bar Council.

There are no proposals to regulate lawyers in the Bailiwick of Guernsey who are not Advocates. The authorities, lawyers and aggrieved persons refer instances of misconduct by lawyers to the professional disciplinary bodies by which they are regulated.

Most law firms undertake company business, trust and finance business. Advocates will undertake such business for clients wherever resident. English solicitors will provide such services for persons not resident in the Bailiwick.

It is anticipated that the proposed fiduciary business law which will govern the conduct of all forms of fiduciary business will apply to all persons who conduct such business. Advocates and other lawyers will not be exempt from the legislation.

**12.6 Accountants**

There are 404 qualified accountants who are members of the Guernsey Society of Chartered and Certified Accountants, whilst another 72 are associate members with other accounting qualifications (some of whom are qualified accountants in other jurisdictions such as South Africa). Most are employed in fiduciary or other financial services companies, with their other major involvement being audit work. Some accountants also provide tax advice although this will often reflect local

interpretation of schemes suggested from their head office or merchant/investment banks mainly outside Guernsey. Some of the accountants working in Guernsey also work for commercial, manufacturing and retailing businesses.

The majority of accountants belong to large accountancy practices or financial service operations, but there are some (perhaps 10% of firms) which comprise three or fewer staff.

*(a) Regulation of accountants*

Accountants operating within the Bailiwick are mostly members of, and regulated by, the professional associations in the United Kingdom, such as the Institute of Chartered Accountants in England and Wales, of Scotland or in Ireland or the Chartered Association of Certified Accountants. In a situation where accountants are acting in a capacity which requires supervision or regulation by the Commission, (eg administering collective investment funds) they will be supervised/ regulated to the same standard as all others participating in such activity. This will also be the case when accountants act as trustees or provide corporate services when such activities are covered by the proposed fiduciary business law.

Like law practices, accountancy firms are often involved in fiduciary services. Such services may be carried on in a company owned by the partners or the partnership itself, although the former approach is prevalent. It is envisaged, therefore, that it will be the company carrying on the business that will be subject to the new law. It is predictable, therefore, that those partnerships not so organized at present will promptly hive off all such business into a company. If they do not, the partnerships themselves will be subject to the law and all its requirements.

# 13 CRIME PREVENTION POLICIES AND STRUCTURES

### 13.1 Strategy

The strategy of the States of Guernsey for preventing, investigating and prosecuting all types of financial crime is:

> (i) to prevent all types of criminal activity operating in or from the Bailiwick and to pursue all criminal activity that may occur;
>
> (ii) to provide assistance to foreign law enforcement agencies investigating criminal conduct of all types and to be pro-active in developing and maintaining close working relationships with such agencies so as to enhance international law enforcement co-operation; and
>
> (iii) to commit resources to law enforcement commensurate with its strategy to prevent all forms of criminal activity operating in and from the Bailiwick.

The Guernsey authorities are committed to ensuring that money launderers, tax evaders, drug traffickers and other criminals should not be able to launder the proceeds of their crimes through the Bailiwick, and operate from the Bailiwick. In this respect the President of the Advisory and Finance Committee has confirmed to the President of the Financial Action Task Force that the Island's legal, financial and law enforcement authorities fully endorse the Forty Recommendations.

The commitment of the authorities to fighting international crime is matched by the importance which the authorities attach to ensuring that the financial services sector is well regulated.

The authorities have a priority commitment to ensure that cases of possession, importation and dealing in unlawful drugs are investigated and prosecuted so that a drug culture does not develop in the Bailiwick. The authorities believe that a drug free culture in the finance sector is an important element in ensuring that financial crime in the Bailiwick is prevented.

### 13.2 Resources

The States of Guernsey are committed to ensuring that the Courts, Law Officers, Police and Customs have the resources which they need to prevent, investigate and prosecute crime.

*(a) Law Officers*

The Law Officers are appointed by the Crown. There are 9 qualified lawyers and 8 support staff in the Chambers of the Law Officers of the Crown. The Law Officers have responsibility for the institution and conduct of criminal proceedings in the Bailiwick. Criminal proceedings are brought in their name. The Law Officers are not subject to any control by the executive in the performance of their duties. They manifest publicly the independence of their office. In recent years the Law Officers have increased the number of qualified staff by employing three extra lawyers and have made application for another three staff to be employed within the next two years to cope with the growth and anticipated growth in their workload.

*(b) Police and Customs and Excise*

The Guernsey Police Force (which polices all of the islands in the Bailiwick) employs 185 staff comprising 149 officers and 36 civilian staff. The States of Guernsey recently agreed to an increase in establishment of 28 officers over a three year period and an immediate increase of five civilian staff. Of the total number of officers currently serving, 15, inclusive of the Chief Officer, have worked for police forces in the United Kingdom or have spent a significant period on secondment there. The Police Force is regularly inspected and thoroughly reviewed by one of Her Majesty's Inspectors of Constabulary so as to ensure that it is an effective force meeting standards equal to those in the United Kingdom. The Police have a dedicated Fraud Unit, currently employing 4 staff and a Financial Investigation Unit jointly staffed by 2 Police officers and 1 Customs and Excise officer, which works alongside the Fraud Unit.

Guernsey Customs and Excise employ 66 staff of whom 16 are involved in the Investigation Division and 30 are uniformed officers who can be called upon by the Investigation Division. The officers in the Investigation Division deal principally with drug matters in the Bailiwick and co-operate with foreign law enforcement agencies investigating and prosecuting drug trafficking cases or other types of crime normally dealt with by Customs and Excise officers including Customs fraud, breaches of UN Sanctions Orders and European Union customs cases.

Both Police and Customs and Excise officers receive substantial training in the United Kingdom. They regularly attend courses run by United Kingdom Police Forces, H.M. Customs and Excise, National Investigation Service and the National Criminal Investigation Service ("NCIS"). As a result, officers involved with financial investigations are given the NCIS approved and nationally accredited status of "financial investigator". Officers also attend finance based local training courses. Customs and Excise officers also undertake periods of work shadowing or are attached to H.M. Customs and Excise on the basis that close co-operation enhances the obtaining, evaluation and use of intelligence.

There is a close joint working relationship between Guernsey Customs and Police. The emphasis on co-operation is of paramount importance. There is total sharing of information and contacts. Police and Customs and Excise liaise on a regular basis with the Guernsey Financial Services Commission and with all sections of the financial services and business sector. There is close co-operation with Police Forces, H.M. Customs and Excise, and supervisory/ regulatory bodies in the United Kingdom, Jersey and the Isle of Man. In particular, a close working relationship exists with the Serious Fraud Office, The Metropolitan Police, Customs and Excise and the Crown Prosecution Service. Representatives of the Law Officers, Police and Customs and Excise regularly attend meetings of the Joint Action Group on Organized Crime, a group promoted by the Metropolitan Police.

A strong working relationship has been developed with foreign law enforcement agencies particularly in the United States and the rest of Europe.

### 13.3 Drug Trafficking

Legislation dealing with drugs related crime is listed in the Appendix at page 103.

Restraint and Confiscation orders can be made in respect of crimes committed in the Bailiwick or in specified countries. The 151 countries specified by the United Kingdom have been specified under subsidiary Bailiwick legislation. It is intended that the current drug trafficking legislation should be consolidated and amended early in 1999 to take account of recent changes in the United Kingdom. The Bailiwick will then be in full compliance with the provisions of the Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances ("the Vienna Convention").

### 13.4 All Crimes Money Laundering

The Bailiwick is committed to enacting All Crimes Money Laundering legislation which will be enacted as The Criminal Justice (Proceedings of Crime) (Bailiwick of Guernsey) Law, 1998. The legislation will be similar to the United Kingdom All Crimes Money Laundering legislation. Once this is in force in early 1999 the Bailiwick will be in compliance with both the Financial Action Task Force Recommendations and the European Union Money Laundering Directive.

### 13.5 Other Legislation

The Island authorities already have in force a comprehensive range of legislation which is deployed in combating and

prosecuting all types of criminal activity and ensuring disclosure of criminal conduct. The Island authorities legislate along similar lines to equivalent legislation in force in England and Wales. Hence in the fields of Theft, Drugs, Extradition, Insider Dealing and Terrorism legislation is virtually identical to that in force in England and Wales. As noted above, this will soon be supplemented by All Crimes Money Laundering legislation (see Appendix 1).

### 13.6 Proposed Legislation

As the legislation currently in force demonstrates Bailiwick criminal legislation is continually under review. Further legislation is currently in course of enactment or under consideration and in particular provisions similar to those contained in the U.K. Criminal Justice (International Co-operation) Act, 1990 to enable the local authorities to assist further overseas authorities in investigations and the collecting of evidence at the investigation stage (see Appendix 1).

### 13.7 Investigation and prosecution systems

The Law Officers, Police, Customs and Excise and the Guernsey Financial Services Commission co-operate closely in the investigation and prosecution of crime of all types. Whenever there is reasonable suspicion of criminal conduct such cases are investigated. If evidence of criminality is established, prosecutions are instituted by the Law Officers if there is a reasonable prospect of a successful prosecution. (The criteria applied are the same as those in England and Wales.)

The full resources of the Law Officers, Police, Customs and Excise and the Commission are available and are deployed when necessary on a case by case basis. Assistance is also sought from United Kingdom and other foreign supervisory/regulatory and law enforcement agencies as necessary on a case by case basis. The policy is a clear one - to investigate and prosecute all types of crime - and the willingness of the authorities to provide appropriate resources and to legislate as and when necessary ensures that the criminal investigation and prosecution system is an effective one.

The Law Officers, Police and Customs and Excise readily provide assistance to law enforcement authorities requiring assistance in the investigation and prosecution of crime of all types. This includes fraud of all types (including tax crime and money laundering) as well as cases involving drugs and terrorism. The Guernsey Financial Services Commission also provides assistance to foreign supervisory/regulatory authorities and law enforcement agencies.

**PUBLIC PROSECUTORS**

**Guernsey, Alderney and Sark**

| | |
|---|---|
| Attorney-General appointed by Crown | Mr. A. Christopher K. Day, Q.C. |
| Solicitor-General appointed by Crown | Mr. Geoffrey R. Rowland, Q.C. |
| Crown Advocates | 4 |
| Other qualified lawyers | 3 *(to increase by 3 in the next 3 years)* |

**POLICE, CUSTOMS, FRAUD AND FINANCIAL INVESTIGATION UNITS**

**Police**

| | |
|---|---|
| Chief Officer | Mr. Michael H. Wyeth |
| Staff | 159 *(present authorized establishment rising in January 2000 to 177)* |
| Fraud Unit (within Police) | Detective Inspector Ian Morellec |
| Staff | 4 |

**Customs and Immigration**

| | |
|---|---|
| Chief Officer | Mr. John P. Allez |
| Staff | 67 |

**Financial Investigations and Intelligence Unit**

| | |
|---|---|
| Joint Heads | Detective Inspector Ian Morellec |

| | |
|---|---|
| | Mr. Robert Prow, Assistant Chief Customs Officer, Investigation |
| Staff | 2 (Police)<br>3 (Customs) |

# 14 INTELLIGENCE

### 14.1 Access to financial information about individuals and companies

The Bailiwick of Guernsey has never enacted legislation designed to ensure secrecy in relation to financial or other business dealings.

Banks and other financial institutions treat their customers' affairs with the same degree of confidentiality as is the case in the United Kingdom. Common law principles of confidentiality applied by the Courts in England and Wales are applied in the Courts of the Bailiwick but there is a comprehensive range of legislation which enables common law principles to be overridden in criminal investigations and prosecutions (see Appendix 1).

The Law Officers, Police and Customs and Excise share information within the jurisdiction and with law enforcement agencies or other supervisory and regulatory bodies outside the jurisdiction who have a legitimate interest in the prevention, investigation and prosecution of crime of all types.

Income Tax Authority employees are obliged by their oath of secrecy to respect the confidentiality of information received in the course of carrying out their duties. However, the Income Tax Authority will disclose information when ordered so to do by a Guernsey Court, under a Double Tax Agreement or when ordered so to do by the Law Officers exercising a power requiring disclosure.

The Guernsey Financial Services Commission ("the Commission") is required to respect the confidentiality of information acquired by the Commission in the course of carrying out its statutory functions but is able to share information with other authorities in certain cases specified in the Financial Services Commission (Bailiwick of Guernsey) Law, 1987. The Commission also liaises with financial institutions where a client might be suspected of having been involved in some kind of irregularity. Information is communicated to the institution on the clear understanding that it is provided for background intelligence purposes only.

### 14.2 Underground banking systems and shelf companies

The Commission's policies on underground banking systems and shelf companies are dealt with in chapters 6 and 9 respectively.

### 14.3 Suspicious transaction reporting by banks and others

The authorities collaborate closely with financial institutions with a view to identifying criminal conduct of all kinds, including fraud and money laundering. The Guernsey Joint Money Laundering Steering Group has representatives of all private and public sectors bodies concerned in or with the financial services sector. It meets under the chairmanship of the Commission. In March 1997 it published detailed Guidance Notes on the Prevention of Money Laundering (known as "The Rainbow Book"). The Guidance Notes are a statement of the standard expected by the Group of all financial institutions in the Bailiwick. The Group actively encourages all institutions to develop and maintain links with the Financial Investigation Unit to ensure that their vigilance systems are effective and up to date.

The Money Laundering (Disclosure of Information) (Guernsey) Law, 1995 facilitates disclosure by persons who are under obligations of secrecy or confidence. They may do so in cases where there is a reasonable suspicion or belief that money or other profits are derived from or represent the proceeds of criminal actions. Disclosure may be made to the Law Officers, a Police or Customs Officer or the Commission. Suspicious transaction reports received under the legislation are investigated

by the Joint Police and Customs Financial Investigation Unit ("the Financial Investigation Unit"). Where suspicious transaction reports have implications for other jurisdictions appropriate disclosures are made to overseas authorities. As a result of the legislation, the pro-active stance of all of the authorities to encourage disclosure of information and the pedigree and reputation of those institutions in the finance sector, information is regularly disclosed to the authorities where criminal activity is suspected. The enactment of All Crimes Money Laundering legislation in 1999 will arguably increase the number of disclosures although it should be noted that disclosures made under the Drug Trafficking legislation the Terrorism legislation and under the 1995 Law already embrace a wide range of criminal activity.

Between 1992 and 1996 disclosures averaged 150 per year. They are currently running at 200 - 250 per year. Most disclosures are made by banks. The Group and the Commission make special efforts to encourage all institutions in the sector to report suspicious transactions. The Guidance Notes have been distributed to banks, insurance companies, trust companies, lawyers, accountants, investment advisers, bureaux de change, stockbrokers and other institutions. Training courses and seminars are organized and run by the Fraud Investigation Unit for the benefit of staff involved in financial services work.

Provisions in the Drug Trafficking and Prevention of Terrorism legislation make it unlawful to assist another to retain the benefit of the proceeds of relevant criminal activity. There is an onus on persons with relevant knowledge to make disclosure of unlawful activities. The test is a subjective one based on the institution's knowledge of the client. There is no minimum disclosure sum.

The Financial Investigation Unit aims to provide feedback for each suspicious transaction report received. The Unit aims to give this feedback, albeit in most cases it will be on an interim basis, within four months. There is close co-operation with the UK and other authorities. The Unit is very conscious of the need for feedback but feedback is seldom received from supervisors and regulators in the United Kingdom and other countries.

Knowledge possessed by the law enforcement agencies is defined as including a criminal record, being an existing or former operational target or being the subject of a previous disclosure. In 1996 34% of the suspicious transaction reports received by the Unit were in respect of persons already known to law enforcement agencies. In 1997, this figure increased to 55%. This provides a rough indication of the intelligence value of the reported information.

### 14.4 Sharing of intelligence inside the jurisdiction

There is complete sharing of information and intelligence between the Police, Customs and Excise and the Law Officers. Intelligence is also shared by them, the Commission and the Income Tax Authority on a case by case basis subject to their statutory obligations of confidentiality. (see above.)

### 14.5 Sharing of intelligence outside the jurisdiction

The Police and Customs and Excise are able and willing to obtain and share intelligence with other jurisdictions. In particular, information is given to the United Kingdom and foreign authorities and agencies.

The European Communities (Bailiwick of Guernsey) Law, 1973 applies to the Bailiwick the provisions of the European Community to the extent necessary to ensure the arrangements set out in Protocol 3 to the United Kingdom's Treaty of Accession to the Treaty of Rome. The 1973 Law imposes certain obligations to co-operate with other European Community Customs services on matters of mutual concern. The Bailiwick is required to give effect to any reciprocal arrangements made between Member States for securing, by the exchange of information, the due administration of their Customs laws and the prevention or detection of fraud or evasion. The Customs and Excise Investigation Division regularly provides information under this provision.

Suspicious transactions are reported to the Financial Investigation Unit. The following table summarises the average number of reports made to the Unit each year between 1992-1996 and the number of reports in 1997:

| *Institution* | *Average per year 1992-96** | *1997* |
|---|---|---|
| Banks | 136 | 173 |
| Insurance companies | 1 | 8 |
| Other financial institutions | 6 | 7 |
| Trust companies | 4 | 27 |
| Other companies | 0 | 1 |
| Lawyers | 0 | 0 |
| Accountants | 2 | 4 |
| Investment advisers | 0 | 0 |
| Other partnerships | 4 | 4 |
| TOTAL | 153 | 234 |

*Average rounded to the nearest figure

# 15 INVESTIGATION

### 15.1 Obtaining information

The Law Officers of the Crown, Police and Customs and Excise co-operate with and assist law enforcement authorities in the British Isles and elsewhere in all criminal investigations.

In addition to common law powers the Law Officers and Courts have a wide range of statutory powers which enable them to require the production of documents and the provision of information when investigating alleged or suspected criminal activity of all kinds including drug trafficking, terrorism fraud (including tax evasion), insider dealing and in the near future other types of money laundering. The powers are exercised in all cases which merit investigation.

The principal statutory provisions which are of assistance in the investigation and prosecution of crime are:

> (a) the Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991 ("the Fraud Investigation Law"), the Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1996, as amended etc., ("the Drug Trafficking Legislation"), the Company Securities (Insider Dealing) (Bailiwick of Guernsey) Law, 1995 and the Prevention of Terrorism (Bailiwick of Guernsey) Law, 1990. The most wide-ranging and frequently used powers are those under the Drug Trafficking Legislation (see also chapter 13) and the Fraud Investigation Law.

> *(b) the Evidence (Proceedings In Other Jurisdictions) (Guernsey) Order, 1980 ("Commission Rogatoire proceedings" -see chapter 16). For the comprehensive range of current and proposed legislation with a brief synopsis of each piece of legislation see Appendix 1.*

### 15.2 The Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991

The powers under the Fraud Investigation Law can be exercised by the Law Officers in any case in which it appears to a Law Officer:

> (a) on reasonable grounds that there is a suspected offence involving serious or complex fraud, wherever committed; and
>
> (b) that there is good reason to do so for the purpose of investigating the affairs, or any aspect of the affairs, of any person.

The power to assist in the investigation of criminal conduct outside the Bailiwick pre-dated a similar provision enacted much later in the United Kingdom.

There is no requirement that a criminal suspect must have been charged with an offence.

A Law Officer, by notice in writing under the Fraud Investigation Law, may require the person under investigation, (or any other person whom he has reason to believe has relevant information), to attend before him, or persons nominated by him, whether at his Chambers or elsewhere to answer questions or to furnish information with respect to any matter relevant to the investigation. He can require the production by the person under investigation (or any other person) of specified documents or a specified class of documents which appear to him to relate to any matter relevant to the investigation. He may take copies or extracts from the documents and require the person producing them to provide an explanation of any of them. If documents are not produced he may require the person who was required to produce them to state to the best of his knowledge and belief where they are. The Bailiff upon an information laid by a Law Officer may grant a warrant in specified

circumstances authorising any officer of the Police to enter and search premises and take possession of documents relevant to the enquiry.

An officer acting upon a production notice issued by a Law Officer or executing a search warrant granted by the Bailiff may be accompanied by a person whom the Law Officer or the Bailiff has authorised to accompany the officer. The discretionary power to authorise persons investigating the suspected crime in another jurisdiction to accompany a Guernsey officer at the investigation stage is exercised in appropriate cases.

A person is entitled to refuse to disclose or produce information on grounds of legal professional privilege but in such cases the lawyer may be required to furnish the name and address of his client. Legal professional privilege is interpreted in the same way as it is interpreted under equivalent legislation in England and Wales.

A person required to disclose or produce a document in respect of which he owes an obligation of confidence by virtue of carrying on any banking or fiduciary business may invoke such confidentiality unless the person to whom the obligation of confidence is owed consents to the disclosure or production. However, H.M. Procureur has a power to override that duty of confidentiality if he specifically so authorises. When any information is subject to an express statutory obligation of confidentiality, disclosure is not prohibited if it is made to a Law Officer or any person authorised by him.

The legislation includes criminal sanctions in cases of non-compliance and when steps have been taken to falsify, conceal or destroy documents.

A Law Officer has power in the interests of justice to disclose information or documents secured under the Fraud Investigation Law to any person or body for the purposes of an investigation of an offence or prosecution in the Bailiwick, the United Kingdom or a foreign country.

The Fraud Investigation Law does not include powers to compel the making of a witness statement or signed deposition. In many cases witnesses are willing to sign witness statements voluntarily. In some jurisdictions Courts will admit as good evidence a record of interview signed by an investigator in the form of a deposition.

The policy of the Law Officers when dealing with a request for an Order under the Fraud Investigation Law is to provide assistance whenever possible. The Law Officers do not impose a mandatory minimum threshold sum when determining whether to provide assistance. Now that requesting agencies are familiar with the legal basis and procedures, a refusal is exceptional. In practice this means that it is reasonable to proceed on the assumption that assistance will be given.

In investigations where a witness does not voluntarily provide a statement or deposition or the evidence of an investigation will not suffice because a sworn statement or signed deposition is required a Letter of Request (Commission Rogatoire) may be sent. In preparing the Letter of Request information secured under the Fraud Investigation Law and disclosed by a Law Officer may be used to ensure that the Letter of Request is focused and accurate. The Bailiwick authorities do not insist that a Letter of Request must have been transmitted through formal diplomatic channels. Hence a Letter of Request will not be rejected because it has not been passed through the UK Central Authority. (see also chapter 16 for more detail).

In the period 1992 - 1996 the annual average number of fraud cases in which orders were issued was 25 and the number of individual orders issued averaged 40. The number of Letters of Request received averaged only 2 per year. In 1997 there were 32 cases involving 47 orders. Since 1991 most investigations which previously would have been transmitted as Letters of Request are now received as requests for assistance under the Fraud Investigation Law. There has been a corresponding drop in the number of Letters of Request.

In the case of Moore Stephens where a production order had been issued by a Law Officer concerning an alleged tax fraud in a foreign country, the Deputy Bailiff in the Royal Court when giving judgement on an appeal said "I find nothing in the point that the principal victim of the fraud was a foreign government or that it was a fiscal matter. Increasing international co-operation is needed to defeat those who engage in serious crime.

## Assistance given to other jurisdictions at investigation stage (number of cases per year)*

| | *1992-96 Average* | *1997* |
|---|---|---|
| Drugs | 32 | 20 |
| Terrorism | 1 | 0 |
| Fraud | 25 | 32 |
| TOTAL | 58 | 52 |

*The Law Officers encourage applications to be submitted in draft form or for there to be a pre-submission discussion. The numbers of refusals at application stage have been few.

**15.3 The Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1988 as amended etc.**

The applicable legislative measures are the Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1988, the Drug Trafficking (Amendment) (Bailiwick of Guernsey) Law, 1992, the Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1988, the Trafficking (Specified Countries and Territories) Ordinances, 1991 - 1998 and Royal Court Rules which detail the necessary procedures to be followed. Note also: The Customs and Excise (General Provisions) (Bailiwick of Guernsey) Law, 1972 and The Misuse of Drugs (Bailiwick of Guernsey) Law, 1974. As noted in chapter 13 revised legislation has been drafted which will consolidate and extend the Drug Trafficking legislation.

Investigations into drug related crime are dealt with in the Bailiwick by the Guernsey Joint Police and Customs Investigation Unit ("the Joint Unit"). Requests for Production Orders and Warrants are submitted to the Law Officers for their authorisation as required by the Rules of Court. Applications for Production Orders and Warrants after authorisation by the Law Officers are made to the Bailiff usually by an officer of the Joint Unit. The Royal Court also has power to grant restraint and confiscation orders (see chapter 16). Orders are made to assist investigations into drug trafficking into and within the Bailiwick and also at the request of law enforcement agencies in other jurisdictions.

The majority of orders which have been granted under the Drug Trafficking Legislation have been made at the request of law enforcement agencies in the United Kingdom and the United States. In most cases the agencies sought to trace the proceeds of drugs-related crime perpetrated in the United Kingdom or the United States, to establish the current ownership of such proceeds or to discover the extent of assets held for the benefit of the suspect in bank accounts companies or trusts. Particularly close working relationships exist with the law enforcement authorities in the British Isles and France (in both cases because of their geographical proximity) and the United States.

The Bailiwick has entered into asset sharing arrangements with the United States and Jersey. In the case of the United States the arrangements have been formalized under the provisions of the Investigation of Drug Trafficking Offences and the Seizure and Forfeiture of Proceeds and Instrumentalities of Drug Trafficking 1988 (applied to the Bailiwick by a 1996 Exchange of Notes).

**15.4 The Company Securities (Insider Dealing) (Bailiwick of Guernsey) Law, 1995 ("The Insider Dealing Law")**

If a Law Officer is satisfied that there are circumstances suggesting that an offence of insider dealing has been committed under the Insider Dealing Law or under the insider dealing laws of another jurisdiction and that a person in the Bailiwick may have been concerned (directly or indirectly) in the commission of any such offence, he may appoint one or more inspectors to carry out investigations. The inspectors have wide-ranging powers to require any person who has relevant information or documents to answer questions and produce documents. The inspectors may take copies or extracts of documents and take steps to preserve documents.

A Law Officer may make application to the Bailiff for a search warrant in certain defined cases where it is necessary to enter premises, seize documents and require explanations of documents.

In a case where H.M. Procureur is satisfied that any material produced or seized is likely to be of relevance to criminal proceedings in another jurisdiction he may make an ex parte application to the Bailiff to transmit that material to the relevant authority.

### 15.5 The Prevention of Terrorism (Bailiwick of Guernsey) Law, 1990 ("The Prevention of Terrorism Law")

The legislation mirrors the provisions of the United Kingdom Prevention of Terrorism (Temporary Provisions) Act, 1989. It prohibits the giving of money to proscribed organisations and prohibits arrangements which facilitate the retention of terrorist funds.

An officer of the Police may make application to the Bailiff, the Chairman of the Court of Alderney or Seneschal of the Court of Sark for a Production Order for the purposes of a terrorist investigation.

### 15.6 The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law [1999] All Crimes Money Laundering

The States of Guernsey has directed that "All Crimes Money Laundering Legislation" be enacted. It is anticipated that this legislation will be in force early in 1999. It will mirror equivalent legislation in force in the United Kingdom. The Bailiff will have power to grant a Production Order at the request of a Police officer for the purposes of an investigation into whether a suspect has benefited from criminal conduct or the extent or whereabouts of the proceeds of criminal conduct. The application may be made ex parte. The Bailiff will have power to grant a search warrant in an appropriate case. For more detail concerning the proposed legislation see chapter 16.

### 15.7 Customs and Excise

The Customs and Excise Investigation Division also deals with an average of 40 written requests each year for assistance on international fraud investigations normally routed through the International Liaison Team of the National Investigation Service (H.M. Customs), London. Assistance is given if necessary in some cases with the aid of a production notice under the Drug Trafficking Legislation, a production notice under the Fraud Investigation Law, an order under a United Nations Sanctions Order or a Letter of Request.

# 16 JUDICIAL PROCEEDINGS

### 16.1 Judiciary and prosecution

The Judiciary acts independently of the Legislature and the Executive. The Law Officers of the Crown act independently as Public Prosecutors (see chapters 2 and 15).

The courts of the Bailiwick deal speedily with all cases referred to them. Judgements of the courts demonstrate the commitment of the judiciary to play an effective role in the investigation and prosecution of crime of all types including drug trafficking, insider dealing, terrorism and tax evasion. Judicial pronouncements in leading criminal and civil cases reflect the courts commitment.

### 16.2 Obtaining and sharing evidence

The obtaining and sharing of information obtained at the criminal investigation stage is dealt with in chapter 15. See in particular the Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991 ("the Fraud Investigation Law"), The Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1988 (as amended) and the soon to be enacted Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999. As it is the policy of the Guernsey authorities to assist authorities in other jurisdictions, it is also proposed to enact local legislation with provisions similar to those contained in the Criminal Justice (International Co-operation) Act 1990 to assist particularly in the obtaining of evidence at the investigation stage.

### 16.3 The Evidence (Proceedings in Other Jurisdictions) (Guernsey) Order, 1980 (Letters of Request - The Commission Rogatoire Procedure)

In many cases where in the past a Letter of Request (Commission Rogatoire) might have been considered appropriate a request is now made to the Law Officers for a notice to be issued under The Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991. (See below and also chapter 15). However, Letters of Request are still received in appropriate cases.

The Evidence (Proceedings in Other Jurisdictions) (Guernsey) Order, 1980 ("the 1980 Order") formalised in the Bailiwick the Letter of Request procedure. The 1980 Order extended to the Bailiwick certain provisions of the Evidence (Proceedings in Other Jurisdictions) Act 1975 [The 1980 Order also extended to the Bailiwick, the Evidence (European Court) Order, 1976 enabling evidence to be taken at the request of the European Court of Justice for the purposes of proceedings in other jurisdictions]. Application is made to the Royal Court, the Court of Alderney and the Court of the Seneschal in Sark.

Preliminary contact and advice is often sought from the Law Officers and given by them on both the form of the Letter of Request and the procedure to be followed.

The Bailiwick Court must satisfy itself that the request has been made by or on behalf of a court or tribunal in a foreign jurisdiction and be satisfied in a criminal case that the defendant has been charged.

The Courts of the Bailiwick on receipt of a request in a criminal matter may order:

(a) the examination of witnesses (orally or by submission of a written statement); and

(b) the production of documents.

The questions and documents must be limited to those necessary for the prosecution of the court action instituted before the requesting Court.

There is no restriction on the type of offences in respect of which an application may be made nor on the gravity or otherwise of the criminal conduct. Applications will not be allowed in the case of criminal proceedings of a political character.

The Royal Court of Guernsey will appoint a Jurat of the Court as a Commissioner to take the evidence. Witnesses will often produce written statements with appended documents and in such cases the proceedings before the Commissioner will be brief. In other cases, oral evidence will be taken at length. At the conclusion of the proceedings the evidence is transmitted to the requesting Court unless the Court directs otherwise.

The Court will allow a foreign lawyer to appear before the Commissioner provided that an Advocate of the Royal Court has overall control of the case.

In criminal cases oral or written requests received by the Law Officers as prospective Commission Rogatoire proceedings after discussion are often submitted directly to the Law Officers under the Fraud Investigation Law procedure. This alternative procedure is suggested when it is apparent from the request that the information sought can best be obtained expeditiously and more effectively under the Fraud Investigation Law.

When confronted with the information obtained under the Fraud Investigation Law, the suspect or defendant often intimates a plea of guilty, thereby dispensing with the need for sworn statements, testimony or the formal production of documents. If sworn evidence or the formal production of documents is required then a Letter of Request can be made at a later date. Letters of Request are dealt with speedily by the Courts. The Courts do not impose a requirement that the request must have been submitted through formal diplomatic channels.

Persons resident in the Bailiwick cannot be compelled to leave the Bailiwick to give evidence in proceedings outside the Bailiwick.

### 16.4 Extraditions and swearing of evidence

The Extradition Act 1989 applies to the Bailiwick of Guernsey without modification. Parts i - v of the Act have effect as if the Channel Islands were part of the United Kingdom. Under current legislation Bailiwick Courts do not have power to prevent the removal of the defendant to England or Scotland where the extradition hearing is conducted in accordance with the provisions of the 1989 Act.

### 16.5 Prosecutions and penalties

*(a) Independence of Law Officers*

As noted in earlier chapters, the Law Officers of the Crown are appointed by the Crown. The decision of a Law Officer to prosecute an offence in the Bailiwick Courts is based on public policy considerations and prosecution criteria identical to those applicable in England and Wales. It follows that the general policy of the Law Officers is to prosecute a case where there is a reasonable prospect of conviction. The policy of the Law Officers is to assist foreign investigators. They make or support applications to the Bailiwick Courts whenever it is right and just to do so.

If it becomes apparent that civil proceedings should or might conveniently be instituted in the Bailiwick in conjunction with the criminal proceedings, the Law Officers will, where appropriate, arrange for Advocates in private practice to institute such proceedings at the request of the person, agency or authority entitled to bring such proceedings.

*(b) Immunity from prosecution*

The principles with regard to the granting of immunity, if ever granted in Guernsey, would be the same as apply in England and Wales. To date there have been no instances in the Bailiwick when such immunity has been given.

*(c) Prosecutions in Royal Court and Magistrate's Court*

There is a distinction in the Bailiwick between Indictable and Summary Offences. All criminal offences are indictable unless they are specifically enacted as Summary Offences. There are very few Summary Offences. Indictable offences are triable in the Royal Court. Summary Offences can only be tried in the lower Bailiwick courts.

In the past five years there has been only one prosecution in the Royal Court involving criminality in the financial services sector. One case was dealt with in the Magistrate's Court.

During the same period considerable assistance has been given to foreign law enforcement authorities in respect of crime committed outside the Bailiwick by their own nationals or others.

*(d) Sentencing policy of Bailiwick Courts*

Members of the judiciary act independently of the executive and legislature and publicly manifest their independence. Maximum penalties tend to mirror or broadly reflect those in equivalent United Kingdom legislation. The judiciary tend to impose sentences similar to those imposed for equivalent offences in the United Kingdom. The Courts have taken a strong sentencing line on cases involving fraud in the financial services sector and drug trafficking.

**16.6 Restraint and confiscation powers**

Powers to trace, restrain and confiscate assets are contained in the Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1988, as amended and ancillary legislation ("the Drug Trafficking Law") and the Prevention of Terrorism (Bailiwick of Guernsey) Law, 1990 ("the Prevention of Terrorism Law"). Similar powers will be included in the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law (1999), ("All Crimes Money Laundering Legislation").

*(a) Drug Trafficking*

The Drug Trafficking legislation contains powers enabling the Courts to restrain, charge and confiscate property. Assistance is given in relation to investigations and criminal proceedings in Courts in other jurisdictions.

A Court order to freeze (restrain) assets may be obtained on behalf of a designated foreign jurisdiction when court proceedings which may lead to a confiscation order have been or are about to be instituted there; or if a confiscation order has already been made. It is vital that any request for the restraint of assets should make clear whether a confiscation order has been made; and, if not, whether proceedings which may lead to confiscation have been instituted or, if not, when they are expected to begin.

It should be noted that help to restrain and confiscate is not available to all countries. Bailiwick law enables a restraint or freezing order and confiscation to be obtained on behalf of another country only where that country has been designated by subsidiary legislation. A country will be designated in the Bailiwick for assistance when it has been so designated by the United Kingdom. (see also chapter 13).

The majority of requests made under the Drug Trafficking Law are for tracing purposes and the production of documents. When assets are found in the Bailiwick there may be a voluntary transfer of assets to the jurisdiction. On occasions, the agency or authority that has requested the information will not wish to make application for the restraint or confiscation of assets but will wish to observe what will happen to those assets. Exceptionally, a request will be made for restraint and confiscation.

Applications for restraint orders are made by a Law Officer to the Bailiff or if property is in Alderney or Sark and there is urgency then by an application made in Alderney or Sark. They are made on an ex parte basis and will not normally be made in open court. The Royal Court may make and enforce orders for the realisation and confiscation of the traffickers proceeds of drug trafficking. In order to prevent drug traffickers escaping confiscation by entrusting their assets to others, the Court is

also empowered, to restrain and confiscate assets given away or transferred at an undervalue to third parties.

Confiscation Orders are also made in local cases as part of the criminal confiscation and sentencing process.

*(b) The Prevention of Terrorism Law*

The Royal Court has power to make restraint and forfeiture orders on an ex parte application made by a Law Officer to the Bailiff in Chambers. As in the case of the Drug Trafficking legislation there are provisions for urgent applications to be made in Alderney and Sark in exceptional circumstances. There have been applications under this legislation for the purposes of gaining information and tracing assets. No applications have been made for restraint or forfeiture orders.

*(c) The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law (All Crimes Money Laundering Legislation).*

This legislation will come into force early in 1999. The legislation recognises the international nature of, and link between, many different types of criminal activity. It also recognises the ease with which assets may be moved and hidden around the world. It will contain comprehensive provision for the making of restraint charging and confiscation orders in similar form to those contained in equivalent legislation in England and Wales. Accordingly, Bailiwick courts will be empowered, on application, to restrain assets which are identified as being the proceeds of serious crime The Courts will also have power to confiscate property when an offender has been convicted of that crime in a foreign jurisdiction.

The restraint, charging and confiscation of the proceeds of the criminal conduct and the method by which orders, including overseas orders, will be enforced will be very similar to those already in force under the Drug Trafficking legislation. Accordingly the law will enable restraint freezing and confiscation orders to be made on behalf of countries to be designated under subsidiary legislation. The Bailiwick will designate countries designated in the United Kingdom under equivalent legislation.

When dealing with applications for restraint charging and confiscation Orders, whether in relation to local criminal conduct or the enforcement of external Orders, the courts in the Bailiwick will apply equivalent principles to those applied by the courts in England and Wales.

### 16.7 Restraint and confiscation amounts

Between 1992 and 1996 the Joint Police and Customs Financial Investigation Unit received a total of seven requests to restrain funds believed to be the proceeds, directly or indirectly, of drug trafficking amounting to 440,000.

The authorities and Courts act expeditiously in all cases.

# 17 SOME PARTICULAR CASES

### 17.1 Overview

There have been few cases in the last 20 years requiring the prosecution of individuals or companies arising from criminal activity in the financial services sector. When such cases have arisen they have been prosecuted in the appropriate courts. None of the cases would be considered to be a major case when compared with major cases in the United Kingdom. The cases worthy of mention are:

(a) The prosecution of a trust company employee on charges of misusing computer data and forgery - 3 1/2 years imprisonment.

(b)(i) The prosecution of the managing director of a licensed deposit taker for fraudulently inducing investors to invest monies on deposit by dishonestly concealing the fact that the institution was prohibited from carrying on business because its licence to take deposits had been withdrawn -1 year's imprisonment (suspended) and a 28,000 fine.

(ii) The prosecution of a principal shareholder and director of the same institution for conspiring with the managing director in the same fraud - a fine of 40,000 or 1 year's imprisonment in default. The defendant did not pay the fine and served the period of imprisonment.

(c) The prosecution of the principal of a trust company on two counts of theft from clients - 2 years imprisonment. The conviction on one count was quashed on appeal to the Court of Appeal and the sentence on the other reduced to 18 months. The Court of Appeal also discharged a Royal Court deportation recommendation.

(d) The prosecution of the principal of a trust company and also a company with which he was concerned for false accounting and unlawful deposit taking - 1 year's imprisonment.

The Guernsey Authorities have during the same period also assisted in the extradition of two persons resident in Guernsey. None of the above mentioned cases are of sufficient importance to merit a detailed review.

In the last 20 years the major rle of the law enforcement authorities and the courts in cases involving the financial services sector has been in assisting authorities in the United Kingdom and elsewhere in the investigation of criminal conduct committed in the United Kingdom or foreign countries. Assistance has been given in the tracing of property and where appropriate in the restraint and confiscation of the proceeds of drug trafficking.

The setting up of the Guernsey Financial Services Commission ("the Commission) as a new regulatory authority resulted in part from lessons learned as a result of the affairs of Barnett Christie (Finance) Limited which are referred to in detail below. The Commission has been actively involved with institutions in each of the fields in which it acts as supervisor and regulator. Outlines of illustrative cases where action has been taken are set out below. In each case the regulatory stance of the Commission has proved justified, the need for a strict regulatory rgime reinforced and, where appropriate, lessons have been learned.

### 17.2 Barnett Christie (Finance) Limited

In 1976 the Advisory and Finance Committee resolved not to renew the registration of Barnett Christie (Finance) Limited ("BCF"), a deposit-taker registered under the Protection of Depositors (Bailiwick of Guernsey) Ordinance, 1971 ("the Ordinance"). After taking legal advice a decision was taken by the Advisory and Finance Committee that there was no legal obligation to publish the fact that the registration had been withdrawn. It was expected that BCF would not thereafter take

further deposits. However, between 1 January 1977 and December 1978, BCF continued to take deposits. It did so in breach of the criminal law, but in circumstances where the public was not aware that that was so. BCF went into insolvent liquidation in December 1978.

If publication of the decision not to renew the registration had taken place in January 1977 BCF would have almost certainly gone into liquidation at that time and paid a greater dividend (circa 50p in the ) than that actually paid (32p in the ). Furthermore, no one would have invested money in BCF after January 1977. In April 1994, one of the depositors, Mrs Firth ("F"), successfully sued the States for their failure to publish, in January 1977, a list of the then registered deposit-takers which would necessarily have excluded BCF.

A number of other depositors had issued summonses against the States making similar allegations to that made by F. Soon after the settlement of the judgement obtained by F in the "test case" the Advisory and Finance Committee referred the question of compensation for other depositors to the States of Guernsey. The States authorised the Advisory and Finance Committee to settle the claims of depositors who could satisfy the Committee and H.M. Procureur that they were entitled to recover damages in circumstances similar to that of the test case.

In December 1984 the States of Guernsey resolved that a Committee of Enquiry be set up to ensure that the Barnett Christie affair be thoroughly investigated and that the report should be made public. A leading English Queen's Counsel and senior chartered accountant were appointed. Their 159 page report was made public and considered by the States in December 1987. The inspectors did not recommend that depositors should be recompensed in full for the losses incurred because it was never the intention of the States that there should be a guarantee to depositors that their deposits would be repaid. The inspector also noted that the errors which were made were errors of judgement by members of the Advisory and Finance Committee, conscientiously endeavouring to apply legislation. Furthermore, a reasonably alert depositor would have appreciated that deposits with BCF involved some risk over and above the nugatory risk of placing on deposit with, say, the subsidiary of clearing bank.

The inspectors did not consider it appropriate to recommend that any change should be made as to the basis upon which the States had made settlement with depositors. The States had followed the principles established in F's test case.

The inspectors noted that in 1978 the Advisory and Finance Committee had adopted a policy of issuing new registrations only to "banks of stature". The Inspectors approved of this approach. They also noted that the Advisory and Finance Committee's approach to banking supervision had radically altered in the years that had passed since the decision not to renew the Barnett Christie registration. The criteria for registration had been severely tightened, the government department at that time supervising deposit-takers had been expanded, new monitoring criteria had been introduced, and with the introduction of a Banking Supervisor, the approach to banking supervision had been further formalized. The Inspectors noted that the lessons of the affair had been learned.

The States of Guernsey noted the inspectors' report and directed the Advisory and Finance Committee to report to the States with specific proposals for the amendment of the appropriate legislation in line with certain detailed recommendations made by the inspectors. The report specifically noted "with approval the setting up of a Financial Services Commission as a supervisory authority".

In light of the lessons already learned from the affair, in May 1986 the States had resolved that a Commission to be known as the "Guernsey Financial Services Commission" should be created. The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 was enacted and the Commission commenced functioning on 1 February 1988.

In December, 1988 the Advisory and Finance Committee reported to the States on the settlement of depositors' claims in accordance with the terms of the settlement which had been accepted by the States in 1984. The managing director and another director of BCF were successfully prosecuted in the Royal Court. The offences and sentences are detailed in paragraph (b) on page 97.

### 17.3 Baring Brothers (Guernsey) Limited

Barings (Guernsey) Limited (then known as Baring Brothers (Guernsey) Limited) is a licensed bank under the Banking Supervision (Bailiwick of Guernsey) Law, 1994 ("BSL"). Barings (Guernsey) Limited's own problems arose initially from the fact that the funds it had placed with Barings in London could not be released because that company was in

administration and, technically, the local operation was insolvent. The Commission immediately imposed a condition on the bank's licence that it should not accept or pay out any money without the consent of the Commission. Barings (Guernsey) Limited was (and still is) custodian/trustee to a number of collective investment funds and to several unit-linked life funds, many of the former managed by its sister company Guernsey International Fund Managers Limited ("GIFM"). GIFM at all times continued to be solvent and traded as normal throughout the Barings/Leeson affair.

It was clearly advantageous to ensure that Baring Brothers (Guernsey) Limited did not go into liquidation as it had very considerable financial and strategic value and would be material to any deal that might be struck. Once in liquidation the bank would have had to cease trading and could not have been resurrected. The Commission, therefore, agreed with the management of the bank that they should not open the doors on the Monday morning (27 February 1995) but should try to carry out outstanding transactions. Any transaction which was an exception to the condition then attaching to the bank's licence had to be approved by the Commission. Such decisions were difficult for the bank's management to propose and for the Commission to agree to since the bank was, on any reasonable view, insolvent. In practice, the Commission was relying on the limitation of liability provided under the BSL so long as it was acting in good faith. (Section 55 of the BSL states "No liability shall be incurred by... the Commission, or by any member, officer or servant... in respect of anything done or omitted to be done after the commencement of this Law in the discharge of any function conferred by or under this Law unless the thing was done or omitted to be done in bad faith".) Clearly this was a calculated risk but one which was judged to be in the best interests of depositors and worth taking to preserve value in Guernsey in the short and long term.

Decisions were made daily - even hourly -always bearing in mind that in the Commission's view it was in the best interests of the depositors that the bank was not put in liquidation but rather kept as a going concern until a buyer was found. At times it was necessary to dissuade creditors and their legal representatives from forcing the bank into liquidation by advising them that they could disadvantage their position - ie they would not receive interest on their deposits and it made it less likely that the bank would be sold. The Commission was only able to sustain this position for so long as it appeared likely that the group was likely to be sold as a group and as a going concern.

The administrators in London, against all the odds, were successful in selling the whole Barings group, which included a large and valuable asset management sub-group, to ING thereby securing the interests of all customers and counterparties of the group, an infinitely more favourable outcome than piecemeal disposal of parts of the group in liquidation. However, in reviewing the situation after the event, it was pretty clear that no matter how tight the ring fence might have been around the Guernsey bank, and even had it not placed funds with the bank in London, it is doubtful whether the local operation would have survived the failure of the parent bank. What became evident as the crisis unfolded was that counterparties immediately took steps to hold on to what funds they had, irrespective of what part of the Barings group they were due to. In any case, had the parent bank failed the important ingredient of confidence would have been fatally damaged.

One positive point was that it was much easier to deal with the crisis as it unfolded with the supervisors of banking, investment business and insurance under one roof, working together and with a chief executive (Director General) who had the authority to decide between them where the best interests of the public lay in any given situation.

This in turn meant that the Commission could devote all its time and energies to the central object - of maintaining the status quo so that a prospective buyer could feel that they were getting a group retaining essentially its existing value rather than the much less attractive debris of a group which had collapsed. Provided that the group was acquired intact and recapitalized, the depositors with the Guernsey bank were assured that their money was 100% intact, as opposed to a proportionate dividend which they would have received in a liquidation. This thought ruled everything that the Commission decided in the difficult two weeks while the sale was negotiated.

Some supervisors/regulators who dealt with the group were less focused on this central consideration and some appeared more concerned with their own position. Their demands for guarantees, injections of capital etc contrasted with the supportive stance maintained by the Commission. Just how important the latter was only came home to Commission officials when the chairman of Barings Guernsey called on them after the crisis was over and stated: "If you had not taken the supportive attitude which you did throughout, it is no exaggeration to say that it would not have been possible to negotiate the sale to ING or any other acquirer."

### 17.4 Insurance Company x

Insurance company x was a subsidiary of a European Union Member State licensed insurer in good standing with the

authorities in that Member State. The Insurance Division became suspicious following a change in ownership of the parent company and the injection of inappropriate assets into that company. The Commission suspended the registration of the insurance company by imposing conditions, despite the parent being still of good standing in its home country. Conditions were imposed by the Commission to the effect that the company was to cease writing insurance business of any description. Both companies were ultimately placed in compulsory liquidation.

### 17.5 Insurance Company y

The insurance manager of the captive of a media group was under pressure to move monies back to the parent and the remaining moneys would have been insufficient to meet the possible future liabilities of the captive.

The insurance manager reported, (as required), the possible material change of circumstances and a condition was imposed to the effect that no monies should leave the insurer without the express written permission of the Commission. The Commission understands that the insurer was the only solvent company in the group - it was subsequently liquidated releasing surplus funds to the liquidator.

# LEGISLATION

## CRIMINAL LEGISLATION AND OTHER LEGISLATION FACILITATING THE RESTRAINT, CHARGING, FORFEITURE AND CONFISCATION OF THE PROCEEDS OF CRIMINAL CONDUCT.

**1. Legislation currently in force -**

**The Theft (Bailiwick of Guernsey) Law, 1983**

The Law is similar to the Theft Act 1968 as amended. It is the Bailiwick legislative measure dealing with offences of dishonesty including theft, false accounting, deception and includes enforcement and procedure provisions.

**The Criminal Justice (Fraud Investigation) (Bailiwick of Guernsey) Law, 1991**

The Law gives power to a Law Officer to make a production order in any case where it appears to him that on reasonable grounds, there is a suspected offence involving serious or complex fraud, wherever committed and there is good reason for him to exercise such powers. The Law also provides for the issue of a warrant in appropriate cases and for information to be disclosed for the purpose of a prosecution in the United Kingdom or a foreign country.

**The Drug Trafficking Offences (Bailiwick of Guernsey) Law, 1988 (as amended) and subsidiary legislation and Rules of Court**

The Legislation gives additional powers to the Royal Court's to deal with drug trafficking. It gives power to trace, freeze and confiscate, facilitates the investigation of drug trafficking and the enforcement in the Bailiwick of restraint and external confiscation orders if a country has been specified in subsidiary legislation.

The Bailiff may make orders for the production of material relevant to drug trafficking investigations and grant search warrants.

**The Prevention of Terrorism (Bailiwick of Guernsey) Law, 1990**

The Law prohibits terrorist activities and organisations. The Law also makes provision for seizure and forfeiture of terrorist funds and for investigation, restraint and confiscation orders. Forfeiture and restraint orders made in other jurisdictions can also be enforced.

**The Company Securities (Insider Dealing) (Bailiwick of Guernsey) Law, 1996**

The Law prohibits dealing in securities by insiders holding unpublished price-sensitive information and persons who obtain information from insiders. There is power to appoint investigators, grant search warrants and transmit information to prosecutors in other jurisdictions for the purpose of a criminal prosecution.

**The Money Laundering (Disclosure of Information) (Guernsey) Law, 1995 and The Money Laundering (Disclosure of Information) (Alderney) Law, 1998**

The Laws facilitate the disclosure of information in relation to the proceeds of criminal activity. They give statutory protection to an informant who would otherwise be subject to an obligation of secrecy, confidence or other restriction on disclosure of information.

**The Computer Misuse (Bailiwick of Guernsey) Law, 1991**

The Law prohibits the activity of securing unauthorised access to any program or date held on a computer, and modification of its contents. There is power for a judicial officer to issue search warrants. Provisions assist the prosecution of crimes committed across national boundaries by modifying rules governing territorial jurisdiction.

**The False Documents and Domicile, etc (Bailiwick of Guernsey) Law, 1998**

The Law makes it an offence for a person to provide or procure, or hold himself out as being able to provide or procure, any false document, address, personal identity or other purported evidence of such matters. It also makes it an offence to purport falsely to be domiciled or resident in the Bailiwick.

**The Extradition Act 1870 - 1989**

The Acts apply to the Bailiwick. In addition to the power to extradite persons to other jurisdictions in order to stand trial, the Secretary of State has power to require a judicial officer to take evidence for the purpose of a criminal matter pending in a court or tribunal in a foreign state.

**The Insolvency Act 1986**

Section 426 of the Act provides for co-operation between courts in the British Isles exercising insolvency jurisdiction. The recipient court is obliged to assist and act in aid of the requesting court's order in matters of insolvency.

**The Evidence (Proceedings in Other Jurisdictions) (Guernsey) Order, 1980**

The Order made under section 10 (3) of the UK Evidence (Proceedings in other Jurisdictions) Act 1975 makes provision for the Royal Court and the Courts in Alderney and Sark to take evidence in civil and criminal proceedings upon receipt of a Letter of Request. In the case of a request in a criminal matter proceedings must have been instituted in the jurisdiction of the requesting court.

**The Law Reform (Miscellaneous Provisions) (Guernsey) Law, 1987**

The Law gives power in civil proceedings to the Royal Court to grant interlocutory injunctions so that (for example) property (including bank accounts) can be restrained. An injunction may in exceptional circumstances be granted notwithstanding that proceedings have not been or are not to be instituted before the Royal Court. The European Communities (Bailiwick of Guernsey) Law, 1973 The Law imposes obligations on Bailiwick authorities to co-operate with other customs services on European Community matters of mutual concern including the exchange of information.

**2. Legislative measures in course of enactment or which will be promoted:**

**The Theft (Bailiwick of Guernsey) (Amendment) Laws, (1998/1999)**

The amendment will facilitate the prosecution of certain offences involving money transfers and deception in line with the recommendations made in England in 1996 by the Law Commission following similar amendments recently made in England.

The States of Guernsey have resolved that Bailiwick legislation be introduced similar to the provisions of Part I of the 1993 Criminal Justice Act to facilitate the prosecution of fraud committed across national boundaries by replacing the current rules governing territorial jurisdiction. Part I of the Act has not been activated in the United Kingdom resulting in adverse criticism of the United Kingdom government particularly in the Court of Appeal. The legislation is likely to be introduced in the Bailiwick in 1999. It will be implemented as and when the United Kingdom activates its dormant legislation.

**The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, (1999)**

The States of Guernsey have resolved that All Crimes Money Laundering Legislation be enacted. The legislation will be similar to the All Crimes Money Laundering Legislation in force in the United Kingdom. It will create basic money laundering offences to supplement those enacted in Drug Trafficking and Prevention of Terrorism legislation.

It will contain provisions enabling restraint and confiscation orders to be made in respect of the proceeds of criminal conduct. Assistance will be available to those countries designated by subsidiary legislation. The Bailiwick will designate those countries which are designated by the United Kingdom.

**The Drug Trafficking (Bailiwick of Guernsey) Law, (1998/1999)**

The Law Officers have prepared a working draft of proposed new Drug Trafficking legislation and submitted it to the Home Office for comment. The Law Officers will recommend that the Advisory and Finance Committee should speedily promote the necessary law reform. It is anticipated that the States will adopt measures recommended by the Committee at the request of the Law Officers and that the legislation will be enacted in 1999.

**The Criminal Justice (International Co-operation) (Bailiwick of Guernsey) Law 1999**

A draft of this legislation is nearing finalisation and the Law Officers will consult with the Advisory and Finance Committee with regard to the latter promoting such legislation, the most important purpose of which would be to enable the local authorities to provide yet further assistance to overseas authorities in the obtaining of evidence for investigation purposes.

Also under consideration is the desirability of enacting legislation incorporating provisions similar to those contained in the Police and Criminal Evidence Act with regard to Police and Customs powers to obtain evidence.

# LEGISLATION PERTAINING TO THE SUPERVISION AND REGULATION OF FINANCE BUSINESS

**1. Legislation currently in force:**

**The Borrowing (Control) (Bailiwick of Guernsey) Law, 1946 and Ordinances made thereunder as amended**

The Control of Borrowing legislation was introduced primarily in order to control credit within the Bailiwick. In essence, the legislation requires the Advisory and Finance Committee's consent to be sought in respect of the raising of money in the Bailiwick by the issue of shares by a company (including the formation of a company), units in a unit trust scheme (including the formation of a unit trust scheme) or partnership interests in a limited partnership (including the formation of a limited partnership); the raising of money outside the Bailiwick by Bailiwick entities; and the borrowing of certain amounts

of money. The Control of Borrowing legislation has, for some time, been used for supervisory/ regulatory purposes rather than for credit purposes.

**The Protection of Depositors, Companies and Prevention of Fraud (Bailiwick of Guernsey) Law, 1969 as amended**

The Protection of Depositors legislation was introduced primarily to supervise deposit-taking activities and has been superseded by the Banking Supervision (Bailiwick of Guernsey) Law, 1994 in that regard. The remaining provisions allow the Guernsey Financial Services Commission to control the use of the word "insurance" or any cognate expression in the name of a business.

**The Insurance Business (Guernsey) Law, 1986 as amended (and rules and regulations made thereunder)**

This law prohibits the carrying on of insurance business in Guernsey and Alderney unless the insurer is registered by the Guernsey Financial Services Commission. The law also requires the registration of insurance intermediaries giving advice on insurance business in Guernsey and Alderney. Persons conducting the above activities without being registered are guilty of an offence.

**The Guernsey Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as amended (and regulations made thereunder)**

The law established the Guernsey Financial Services Commission as a dedicated statutory body responsible for the supervision and regulation of finance business in the Bailiwick. The Commission has additional responsibilities to develop finance business in the Bailiwick and provide assistance to the senior political bodies responsible for economic policy. The law also gives the Commission responsibility to administer supervisory/regulatory legislation and establishes criteria for the sharing of information which is otherwise confidential to the Commission.

**The Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended (and rules and regulations made thereunder)**

This law prohibits the carrying on of investment business except by licensed persons and sets out requirements for the authorisation of collective investment schemes. The Guernsey Financial Services Commission is empowered to grant/ refuse licences and applications for the authorisation of collective investment schemes, to impose conditions, to suspend or revoke licences/ authorisations and to apply to the Courts for injunctions and restraint orders. The law was most recently amended to empower the Commission, if satisfied that the Channel Islands Stock Exchange meets the criteria in the law for granting licences, to license the Exchange, impose conditions thereon, and make rules in respect of the carrying on of controlled investment business by the Exchange.

**The Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended (and rules and regulations made thereunder)**

The Law prohibits the taking of deposits by unlicensed deposit taking businesses. It sets ground rules for the granting and revoking of banking licences. It gives powers to the Guernsey Financial Services Commission to supervise licensed banks according to minimum criteria, including fitness and properness of directors, expertise of staff, adequacy of capital and liquidity and systems and controls. Banks' audited accounts are required to be made publicly available. Restrictions are placed on the use of banking descriptions and names.

**The Insurance Business (Financial Guarantee Insurance: Special Provisions) (Guernsey) Law, 1996 and Ordinance made thereunder**

This legislation enables the Guernsey Financial Services Commission to designate an insurer as a Financial Guarantee Insurer to be regulated under the provisions of the law and the designated ordinance. Designated Guarantee Insurers

contravening the law are guilty of an offence.

**The Principles of Conduct of Finance Business**

These Principles were issued by the Guernsey Financial Services Commission in 1990 and are based on the document "Principles of Investment Business" issued by the United Kingdom Securities and Investments Board. The Principles apply to all financial institutions in the Bailiwick and are a statement of the standards expected in areas such as integrity; skill, care and diligence; conflicts of interest; information about and for customers; protection of assets; high standards of market practice; financial resources; internal organisation; and co-operation with the Guernsey Financial Services Commission.

**The Principles of Conduct of Derivatives Business**

The Principles were issued by the Guernsey Financial Services Commission in October, 1995 in recognition of the increasing use of derivatives by financial institutions in the Bailiwick. Derivatives business is defined in the widest possible sense and all institutions using derivatives as part of their finance business are expected to comply with the Principles which deal with matters such as resources; know your customer; training and experience; controls; and safe custody. The Principles are a distillation of derivatives guidance and policies established by international supervisory/regulatory organisations and other bodies.

**Guidance Notes on the Prevention of Money Laundering**

The Guidance Notes were issued in March, 1997 by The Guernsey Joint Money Laundering Steering Group which meets under the chairmanship of the Guernsey Financial Services Commission. The Guidance Notes are based on similar Guidance Notes issued by the Joint Money Laundering Steering Group in the United Kingdom. The Guidance Notes are a statement of the prevention of money-laundering standards, procedures and vigilance expected of all financial institutions in the Bailiwick.

**2. Legislative measures in the course of enactment or which will be promoted:**

**The Insurance Business (Sark) Law, 1999**

The law will extend the provisions of the Insurance Business (Guernsey) Law, 1986 to Sark.

**The Fiduciary Business (Bailiwick of Guernsey) Law, 1999**

The purpose of this proposed law is to bring the supervision of fiduciary business, including trust companies, company administrators, and professional executors, within the statutory functions of the Guernsey Financial Services Commission. The law (or a separate law) will increase the statutory responsibilities of company directors.

# LEGISLATION PERTAINING TO TRUSTS, COMPANIES, LIMITED PARTNERSHIPS AND PARTNERSHIPS

**1. Legislation currently in force:**

**The Trusts (Guernsey) Law, 1989 as amended**

The law states the circumstances in which a trust is deemed to exist and makes provision as to the creation and validity of Guernsey trusts and the jurisdiction of the Guernsey courts in trust matters. The law also deals with the appointment, duties

and powers of trustees and their liability for breach of trust. Provisions exist for the "tracing" of trust property, the liability of directors of corporate trustees and the protection of bona fide purchasers of trust property.

**The Companies (Alderney) Law, 1994 (and regulations made thereunder)**

The law repealed the 1894 law and its amendments and replaced them with comprehensive modern legislation. The law provides for a distinction between public and private companies. It also abolished the "ultra vires" doctrine and imposed requirements for the submission of annual returns, the maintenance of accounts, minute books and registers, and for the inspection of those records.

The duties of directors are stipulated and any provisions exempting or indemnifying them from liability for negligence, default, breach of duty or breach of trust are declared to be void (although the company may purchase insurance against such liabilities). The Court may also appoint Inspectors to investigate and report on the affairs of a company. Inspectors have extensive statutory powers to call on witnesses and documents.

**The Companies (Guernsey) Law, 1994 as amended (and regulations made thereunder)**

The 1994 law consolidated the laws of 1908 to 1990, and made a number of adjustments to modernise the legislation. These adjustments included the abolition of the "ultra vires" doctrine so as to protect the interests of anyone dealing with the company in good faith. The law requires every company to maintain minute books and registers of officers and shareholders, all of which must be available for inspection.

Accounting records must be maintained and audited annually by a professionally qualified accountant. There are also provisions dealing with the appointment of directors (and the circumstances under which they become personally liable for misrepresentation or breach of fiduciary duty) and voluntary and compulsory windings up, including the circumstances in which the Court may order a compulsory winding up. Finally, there are a range of miscellaneous provisions, which cover matters including penalties and the criminal liability of officers of the company when a company is guilty of an offence under the Law.

**The Partnership (Guernsey) Law, 1995**

Guernsey recognized the partnership concept prior to 1995 under common law principles. However, the enactment of the 1995 limited partnership legislation made it desirable for the law relating to partnerships to be codified on a statutory basis. The Partnership (Guernsey) Law, 1995 is based on United Kingdom partnership legislation.

**The Limited Partnerships (Guernsey) Law, 1995**

The law provides for the statutory formation and registration of limited partnerships in Guernsey and extended Guernsey's Control of Borrowing legislation to include limited partnerships. Guernsey limited partnerships are required to have a minimum of one general partner and one limited partner and must produce annual audited accounts.

**The Companies (Enabling Provisions) (Guernsey) Law, 1996 and Ordinances made thereunder**

The law enables the States to make provision by ordinance for the incorporation of Companies limited by guarantee (and guarantee and shares), protected cell companies, the immigration and emigration of companies, the amalgamation of companies, merger relief and the issue of no par value shares. Since 1996 ordinances have been enacted concerning all but the latter two provisions.

**The Companies (Alderney) Law (External Companies) Ordinance, 1998**

The purpose of this ordinance is to require certain non-Alderney companies to register with the authorities in that jurisdiction

in the Register of External Companies.

**2. Legislative measures in the course of enactment or which will be promoted:**

**The Limited Partnerships (Guernsey) Law, 1998**

This law will amend the Limited Partnerships (Guernsey) Law, 1995 by allowing a limited partnership to elect whether or not to have legal personality.

The Companies (Merger Relief and Relief in Respect of Group Reconstructions) Ordinance, 1998

The intention behind this ordinance is to add to the existing mechanisms available which allow potentially non-distributable moneys to become distributable by providing for certain circumstances in which a company need not establish or add to a share premium account.

**The Companies (Shares of No Par Value) Ordinance, 1998**

This ordinance will enable Guernsey companies to issue shares of no nominal or par value. The rgime of par value shares will continue but the new ordinance will, for example, allow Guernsey incorporated funds to issue/redeem shares to/from investors without the need to consider nominal share values.

## LEGISLATURE AND EXECUTIVE

### Guernsey

| | |
|---|---|
| Parliament: | The States of Guernsey |
| Members: | 57 |
| | 12 elected by simple majority - Island constituency<br>33 elected by simple majority - Parochial constituencies<br>10 elected by Douzaines (Parish Councils) |
| Electoral System: | 2 elected by States of Alderney |
| Speaker: | Sir Graham Dorey, Kt. |
| | Advisory and Finance Committee |
| Leading Committee: | President, Conseiller Laurence C. Morgan |
| Members: | 6 |
| States Supervisor: | Mr. Michael J. Brown, F.C.A. |

### Alderney

| | |
|---|---|
| Parliament: | The States of Alderney |
| Members: | 10 |
| Electoral System: | Single constituency elections by simple majority |
| Speaker: | Mr. Jon Kay-Mouat, O.B.E. |
| | Policy and Finance Committee<br>Chairman: Mr. John A. Buggy |
| Leading Committee: | Members: 4 |
| Clerk of the States: | Mr. David V. Jenkins |

### Sark

| | |
|---|---|
| Parliament | The Chief Pleas |
| Members: | 52 |
| | 40 seats by virtue of land tenure |
| Electoral System | 12 elected by simple majority in single constituency |
| Speaker: | Mr. Lawrence P. de Carteret |
| Leading Committee: | General Purposes and Advisory Committee |
| | Mr. J. Michael Beaumont |
| Chairman: | Members: 4 |

## JUDICIARY

### Guernsey

Bailiff

| | |
|---|---|
| appointed by Crown | Sir Graham Dorey, Kt. |
| Deputy Bailiff<br>appointed by Crown | Mr. de Vic G. Carey |
| Magistrates:<br>appointed by Royal Court | 2 |
| Jurats:<br>appointed by electoral college | 12 |
| **Alderney** | |
| Chairman of the Court:<br>appointed by Home Secretary | Jurat Colin W. Partridge |
| Jurats:<br>appointed by Home Secretary | 7 |
| **Sark** | |
| Seneschal<br>appointed by Seigneur of Sark | Mr. Lawrence P. de Carteret |

# 1 INTRODUCTION

### 1.1 Introduction

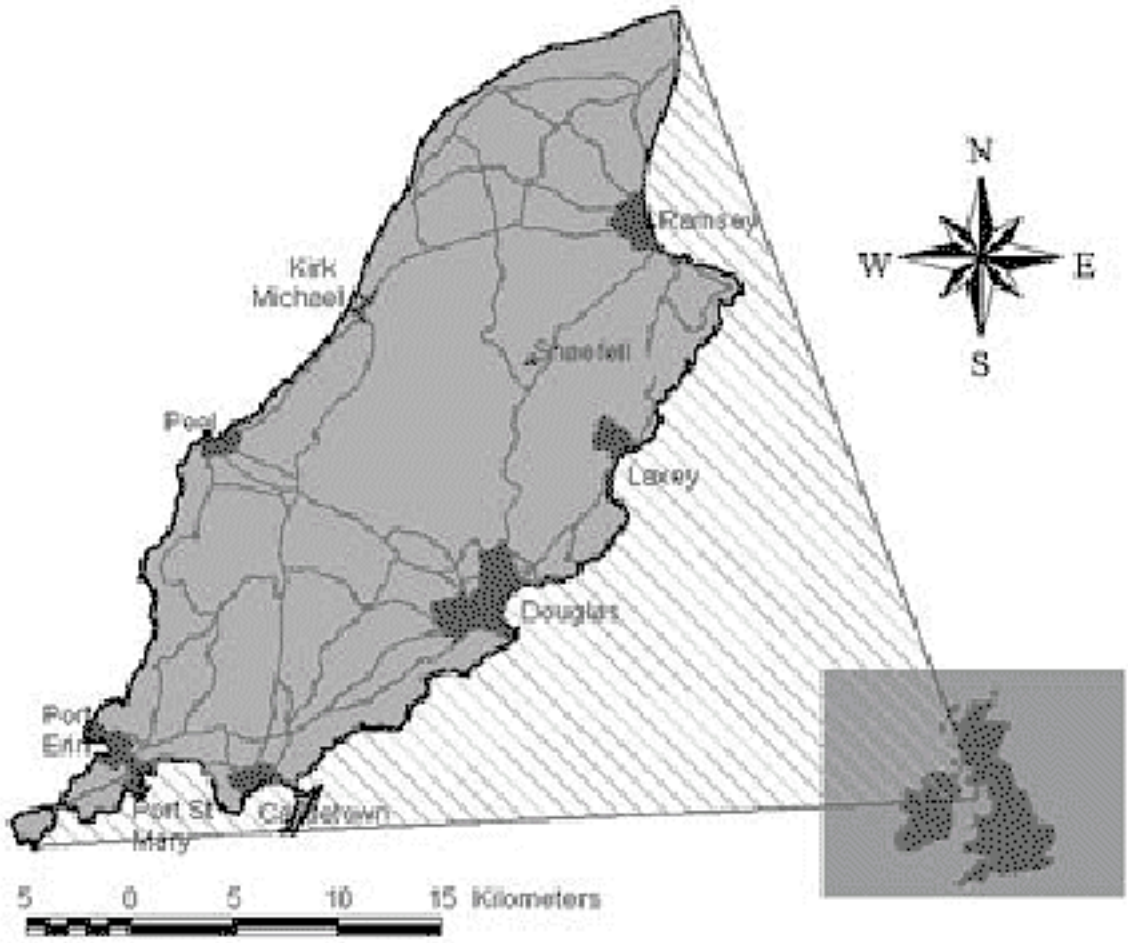
The Isle of Man occupies a central position, not only in the Irish Sea, but also in the British Isles. The Island is some 33 miles (52 kilometres) long from north to south and 13 miles (22 km) wide from east to west at the widest point.

The coastline, which is over 100 miles (160 km) long, encompasses an area of 227 square miles (572 sq. km.). A range of hills stretches obliquely across the Island, the highest point being Snaefell at 2,036 feet (621 metres). Around the Island's flat northern plain are long sandy beaches which contrast markedly with the rocky cliffs and sheltered bays around the rest of the coastline. Over two thirds of the land mass is cultivated, principally the fertile northern and southern plains.

### 1.2 Population

The Island's population is estimated at 73,100 (71,714 at the 1996 Census). The population is in natural decline, i.e. deaths exceed births, but this is more than offset by net immigration and the population has increased by some 11,200 over the last 20 years. In the last 10 to 12 years in particular, immigration has been mainly by economically active younger persons. As a consequence, the age profile of the population, which was a particular problem a decade ago, has improved significantly.

The population of the Island is similar in number to the two main Channel Islands. However, the Isle of Man is five times larger in area than Jersey and nine times larger than Guernsey, with the result that population density is much lower. The Island's population density is about half of that of the United Kingdom.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# 2 CONSTITUTION, LAW AND JUSTICE

## 2.1 Constitutional Background

The Isle of Man first came under the English Crown in the fourteenth century following periods under the suzerainty of the Kings of Norway and Scotland. In 1405, the Island, with its "regalities" was granted by the Crown to Sir John Stanley and his heirs. From then, up to 1765, it was ruled by the Stanleys, the Earls of Derby and later the Dukes of Athol as Kings or Lords of Man. By Acts of Parliament passed in that year and in 1825, the rights of the Lords of Man were revested in the Crown and, for a time, the Island was very largely governed from London.

*The Crown*

The modern constitutional relationship between the British Crown and the Island dates from 1866 when an Act of Parliament was passed separating Manx revenues from those of the United Kingdom and giving the Island a limited measure of control over insular expenditure. Since then, a long series of measures, particularly over the last 40 years, has transferred control more and more into local hands. The Island remains a Crown Dependency but is now largely self-governing.

The Crown retains responsibility for the Island's defence and external relations (for which the Island makes an annual payment to the United Kingdom Government) and has ultimate responsibility for the good government of the Island. Westminster is empowered to legislate for the Island but, by convention, does not do so without the consent of the insular authorities. Primary legislation passed by the Island's own Parliament requires the Royal Assent before it can be given effect and the Crown appoints a Lieutenant Governor, two Deemsters (Judges) and the Island's Attorney General.

The Crown acts in Island affairs on the advice of the Privy Council with the Home Secretary having particular responsibility for tendering advice. Official communications between the Island and the United Kingdom Government are channelled through the Home Office.

*The European Union*

The Island has a special relationship with the European Union (EU) based on Protocol 3 of the Treaty of Accession by which the United Kingdom joined the European Communities. It is a limited relationship which is confined to ensuring free movement of goods and agricultural products and conformity with EU customs arrangements. The Island neither contributes to, nor receives support from, the EU Budget.

*International Agreements*

Any treaty or international agreement to which the United Kingdom Government becomes a party is not considered as applying automatically to the Island. Any such treaty or agreement may, however, expressly be applied to the Island, following consultation with the Island.

## 2.2 Insular Administration

*Tynwald*

The Island's Parliament, known as Tynwald, has a long history traceable back over a thousand years and has a long and

strong democratic tradition which includes giving votes to women in 1881, well before England and Wales. It does not derive its legislative competence from any grant from the Crown, or from any grant of authority by the Parliament at Westminster. Tynwald was and is a Parliament of an ancient Kingdom. It comprises two Branches. These are the House of Keys (24 Members, popularly elected), and the Legislative Council (11 Members, all but two of whom are elected by the House of Keys, the others being the Lord Bishop and the Attorney General). These Chambers sit separately in public and each considers primary legislation. The Keys and the Council sit together in public in a third Chamber, Tynwald, to debate policy, to consider secondary legislation and to vote monies.

The procedure for passing primary legislation (an Act of Tynwald) is very similar to that of the Westminster Parliament. Each Branch will give a Bill three readings. Bills are treated as passed when they receive the Royal Assent and that Assent is announced in Tynwald.

Government policy and finances are subjected to scrutiny and endorsement by Tynwald through an annual Policy Document considered each October and a Budget considered each March. This bi-annual scrutiny process provides a "rolling accountability" which suits a political environment from which political parties are largely absent.

A register of the interests of Members of Tynwald is maintained in which Members are required to record their interests comprehensively, including all directorships, employments, pecuniary interests, shareholdings and investments. Members are not appointed to Departments of Government where their private interests would conflict with the responsibilities of the Department. In the case of an occasional conflict of interest, this is declared and the Member takes no part in the relevant decision-making process.

**LEGISLATURE**

| | |
|---|---|
| **Parliament:** | Tynwald, comprising<br>Lower House - House of Keys<br>Upper House - Legislative Council |
| **Members:** | House of Keys 24<br>Legislative Council 11 |
| **Electoral System:** | House of Keys - constituency<br>elections by simple majority<br>Legislative Council - 9<br>elected by the House of Keys<br>2 ex officio |
| **President of Tynwald:** | The Hon Sir Charles<br>Kerruish, OBE, LLD(hc), CP |
| **Speaker of the House of Keys:** | The Hon. Noel Q. Cringle, SHK |

*The Executive*

Government is by a Ministerial system introduced in 1987. There is a Chief Minister, elected by Tynwald. The Chief Minister, in turn, nominates 9 Ministers to be responsible for the 9 Departments of Government and the Chief Minister and the 9 Ministers serve as a Council of Ministers - in effect, a Cabinet. The Treasury is the Department with a particular responsibility for the Financial Services Sector.

The Treasury is headed by a Minister and three other Members of Tynwald. They are not expected to hold any non-executive directorships which could conflict with their responsibilities to the Treasury. Where there is a potential for private interests to be material and relevant to the Department's responsibilities, those interests are declared and minuted. Members then refrain from taking part in any consideration of such matters.

The Treasury has a permanent establishment of 302 full-time civil servants, allocated between different divisions as follows:

| | Full-time equivalents |
|---|---|
| Administration | 6 |
| International Services | 7 |
| Customs and Excise | 44 |
| Economic Affairs | 10 |
| Finance | 55 |
| Income Tax | 114 |
| Information Systems | 56 |
| Internal Audit | 10 |
| | 302 |

The Customs and Excise Division includes an Intelligence and Investigation Section which employs 7 staff. These work closely with the Police Fraud Squad. The possibility of establishing a Joint Financial Investigation and Enforcement Unit is under active consideration.

The two principal regulating bodies of the Financial Services Sector are the Financial Supervision Commission and the Insurance and Pensions Authority (see Section 5.3). Both are Statutory Boards which report to the Council of Ministers through the Treasury and each is chaired by a Member of the Treasury.

**EXECUTIVE**

| | |
|---|---|
| **Council of Ministers:** | Chief Minister and 9 Ministers |
| **Departments of Government:** | Department of Agriculture, Fisheries and Forestry<br>Department of Education Department of Health and Social Security<br>Department of Home Affairs<br>Department of Local Government and the Environment<br>Department of Tourism and Leisure<br>Department of Trade and Industry<br>Department of Transport<br>Department of the Treasury |
| **Chief Minister:** | Hon. D.J. Gelling, FInstSMM, FIMgt, MHK |
| **Chief Secretary:** | Mr. J.F. Kissack, B. Com., FIMgt. |

### 2.3 Legal System and Legislation

The Isle of Man is an entirely separate legal jurisdiction to the United Kingdom. It is not part of the realm of England nor is it governed by the laws of England.

However, the system of law which exists in the Isle of Man is a common law system similar to that which exists in England. During recent centuries, the Manx Courts have generally followed English precedents, unless there was some provision in Manx law to the contrary. English precedents are not binding, but are treated as highly persuasive. The Isle of Man has, in practice, become an English common law country by adoption.

On many subjects, a conscious effort has been, and is, made to keep Manx law in line with English law. This is certainly the case with criminal law, contract, tort, regulation of the financial services industry and many aspects of commercial law.

Government legislation is introduced in accordance with a rolling three year programme, revised annually, and approved by the Council of Ministers. Government Bills are drafted in the Chambers of the Island's Attorney General on the instructions

of the Council of Ministers. Two Legislative Draftsmen are employed for this purpose and they are supported by library, administrative and secretarial officers within the Chambers. The Draftsmen are able to call upon the expertise of other legal staff in the Chambers.

The principal legislation relating to financial regulation, fraud and money laundering is listed with brief annotations in the annex. The legislation on the investigation of crime and the pursuit of the proceeds of crime follows closely that of the United Kingdom.

### 2.4 Judicial System

The Judicial System of the Isle of Man is recognisably similar to that in the United Kingdom. There are two permanent Judges, the First and Second Deemsters, titles which derive from the 13th Century, if not earlier. The Deemsters are appointed by the Crown after consultation with the Island's Authorities. The Governor has the power to appoint acting Deemsters of the High Court, a power which is exercised for cases of unusual length or requiring particular expertise. In addition, there are two full-time stipendiary magistrates known as the High Bailiff and the Deputy High Bailiff, who deal principally with summary offences.

Civil matters are usually heard at first instance by a single Deemster sitting in the High Court. Criminal proceedings are heard at first instance before one of the stipendiary magistrates or a bench of lay Magistrates, in less serious cases. More serious cases are heard before a Deemster sitting with a Jury of seven in the Court of General Gaol Delivery, the equivalent of the English Crown Court. All criminal cases are dealt with in the same way and there is no special procedure for financial or fiscal cases.

Civil and criminal appeals are dealt with by an Appeal Court which is known as the Staff of Government Division. Appeals are usually heard by a Deemster and a Judge of Appeal who is chosen from prominent members of the English Bar. The Judge of Appeal is appointed by the Crown on the advice of the Home Secretary in London. A Deemster is not permitted to hear appeals against his own decisions.

Where important points of law are at stake, there is a further avenue of appeal to the Judicial Committee of the Privy Council in London.

The Deemsters do not sit as part of Tynwald and the Island's judiciary is independent of the legislature and executive. When the Lieutenant Governor is absent from the Isle of Man, the First Deemster performs the role of Acting Governor. Apart from this occasional duty, the First Deemster has no other official role within the legislature or the executive.

**JUDICIARY**

| | |
|---|---|
| **First Deemster appointed by the Crown:** | Deemster T.W. Cain |
| **Second Deemster appointed by the Crown:** | Deemster J.M. Kerruish |
| **High Bailiff appointed by the Lieutenant Governor:** | A.K. Williamson |
| **Deputy High Bailiff appointed by the Lieutenant Governor:** | T. M. Moyle |

### 2.5 Prosecution System

The Isle of Man does not have a Crown Prosecution Service similar to that in England and Wales. Prosecutions in Courts of Summary Jurisdiction and in committal hearings are usually conducted by a Police Officer, the system being similar to that in place in many areas of England and Wales before the creation of the Crown Prosecution Service. More complex or serious cases before Courts of Summary Jurisdiction are dealt with by legal officers in the Attorney General's Chambers and it is a common occurrence for the Police to seek advice from the Attorney General's Chambers on relevant legal points.

When appropriate, civil proceedings and/or prosecutions can be brought in the name of either the Insurance and Pensions Authority or the Financial Supervision Commission. These cases will involve breaches of the relevant regulatory legislation.

All proceedings before a Deemster and jury in the Court of General Gaol Delivery are conducted in the name of the Attorney General by Legal Officers in the Attorney General's Chambers.

Decisions to prosecute in the Summary Courts are made by the prosecutor (usually the Police).

Proceedings before the Court of General Gaol Delivery are instituted by a document known as an Information which is signed by the Attorney General. That document is, to all intents and purposes, identical to an Indictment under English law.

The office of Attorney General combines the functions of the English Attorney General, the Director of Public Prosecutions and the Director of the Serious Fraud Office. The Attorney General is appointed by the Crown on the advice of the Secretary of State after consulting the Island's Authorities and his first responsibility is to the Crown. As a Crown appointment, the Attorney General is able to take an independent view in relation to criminal proceedings and criminal policy matters. The office-holder is an ex-officio non-voting member of the Legislative Council and attends meetings of the Council of Ministers as legal adviser. The independent position of the Attorney General is illustrated by the fact that he can be called upon to give advice on Manx law to both the Crown and the Island's Authorities.

The policy of the Attorney General is to commence proceedings if there is sufficient evidence to warrant a prosecution and there is a realistic prospect of conviction; proceedings will, subject to accepted criminal policy considerations, then be commenced.

The independence of the Attorney General is further evidenced by the fact that prosecutions have been mounted as appropriate against Departments of Government. The principles which apply to decisions to prosecute in the Isle of Man are, in effect, the same as those applied in England and Wales. Political or commercial pressures do not impinge upon the decision of the Attorney General, Police or Regulatory Authorities in deciding whether to prosecute.

All classes of criminal case, whether they be financial, administrative or other crimes, are subject to the same procedures and considerations in determining whether to prosecute and in the conduct of court proceedings. There is no class of financial crime in respect of which procedures are different to those in other criminal cases.

The Attorney General has the power, as does the English Attorney General, to grant, in effect, immunity from prosecution. There is no general immunity granted in respect of any class of offence and the grant of immunity in any particular case is very rare and requires quite exceptional circumstances.

## PUBLIC PROSECUTORS

| | |
|---|---|
| **Attorney General appointed by the Crown:** | Mr. W.J.H. Corlett |
| **Government Advocate:** | Mr. A.T.K. Corlett |

# 3 ECONOMY AND FINANCE INDUSTRY

### 3.1 The Economy

The Isle of Man Government's core policy in relation to the economy is:

> *"to pursue manageable and sustainable growth based on a diversified economy with the aims of:*
>
> *(a) raising the standard of living of the whole population;*
>
> *(b) securing continuous future prosperity throughout the Island; and*
>
> *(c) providing the resources needed to sustain public services*."

Historically, the Island's economy was based on tourism and agriculture. The relative decline of these industries over the last 35 years has required the Island to diversify and, whilst agriculture and tourism continue to make their contribution, the economy is now led by financial services (37% of GDP) and manufacturing (10% of GDP). National Income is increasing steadily but remains comparatively modest, with GDP per head, being some 79% of average United Kingdom levels (latest figures for 1995/96).

The cost of living in the Island is substantially the same as that in the United Kingdom. Prices of imported goods and energy costs tend to be higher but these are offset by, in particular, lower housing and related costs.

The Island is in currency union with the United Kingdom, although the Island issues its own currency which is legal tender only within the Island. Interest rates are, therefore, similar to those applying in the United Kingdom and the rate of inflation changes broadly in line with United Kingdom movements.

The growth of the Island's economy and the comparison of the Island's GDP per head with that of the United Kingdom during 1985/86 to 1995/96 is shown in the following table:

**Isle of Man Gross Domestic Product**
**1985/86 to 1995/96**

| | *Isle of Man GDP (Constant Prices 000's)* | *Isle of Man GDP per head as a percentage of United Kingdom* |
|---|---|---|
| 1985/86 | 314,857 | 57 |
| 1987/88 | 412,125 | 67 |
| 1989/90 | 492,425 | 71 |
| 1991/92 | 521,278 | 77 |
| 1993/94 | 538,875 | 77 |
| 1995/96 | 584,442 | 79 |

The change in relative importance of the sectors of the Island's economy over the same period is shown in the following table:

**Income Generated in Basic Sectors from Manx Sources 1985/86 to 1995/96 (Constant Prices)(000's)**

| | *1985/86* | *%* | *1995/96* | *%* |
|---|---|---|---|---|
| Manufacturing | 51,591 | 15 | 65,140 | 10 |
| Finance | 75,686 | 22 | 242,212 | 37 |
| Tourism | 40,441 | 12 | 37,887 | 6 |
| Construction | 30,869 | 9 | 36,498 | 6 |
| Agriculture & Fisheries | 9,698 | 3 | 9,548 | 1 |
| Public Administration | 24,021 | 7 | 36,127 | 5 |
| Professional & Scientific Services | 41,413 | 12 | 98,827 | 15 |
| Other Services | 76,611 | 22 | 131,276 | 20 |
| **Total** | **359,329** | **100** | **657,515** | **100** |

Numbers in employment in the various sectors at the time of the last Census in 1996 were as follows:

The most recent data available on employment show 36,224 persons employed (June, 1998) and 386 persons unemployed (June, 1998). The rate of unemployment in April 1998 was just 1.1%.

### 3.2 Public Expenditure

The Island has well-developed education, health and welfare services provided by Government and publicly funded which are broadly comparable to, and in a number of respects more generous than, the equivalent public services provided in the United Kingdom. The principal sources of finance for the net funding of these services are:

## Employment in Sectors of I.O.M. Economy (1996)

| | | % |
|---|---|---|
| Agriculture, Forestry and Fishing | 938 | 3 |
| Manufacturing | 3,562 | 11 |
| Construction | 3,372 | 10 |
| Electricity, Gas and Water | 462 | 1 |
| Transport and Communications | 2,688 | 8 |
| Wholesale Distribution | 781 | 2 |
| Retail Distribution | 2,911 | 9 |
| Financial Services | 5,942 | 18 |
| Professional Services | 6,081 | 18 |
| Tourist Accommodation | 765 | 2 |
| Entertainment and Catering | 1,156 | 3 |
| Miscellaneous Services | 2,773 | 8 |
| Public Administration | 2,146 | 6 |
| **Total** | **33,577** | **100** |

Note: Classifications based on main source of employment. Secondary employment is excluded.

**Employment in the Financial Services Sector (1996)**

| | | % |
|---|---|---|
| Banking | 1,781 | 5 |
| Insurance | 1,657 | 5 |
| Other financial institutions | 1,229 | 4 |
| Property | 536 | 2 |
| Other | 739 | 2 |
| **Total** | **5,942** | **18** |

Indirect taxation and National Insurance contributions are, for most practical purposes, the same as those in the United Kingdom. The Island has, therefore, a relatively broad tax base and the funding of Government services is not wholly dependent upon taxes on income. Taxation revenue on the Island expressed as a proportion of national income is similar to that in the United Kingdom.

The Island is statutorily required to operate a balanced budget. There is no National Debt to speak of and the Island's administration has been able to build up a modest Reserve Fund of some 128 million.

Government's net revenue expenditure, estimated for 1998/99, is 264 million. This expenditure represents some 41% of GDP. In addition, there is annual capital expenditure of nearly 40 million.

### 3.3 Finance Industries

*Origins of the Sector*

The Island's economic policy is not geared exclusively to the development of the Financial Services Sector but to the creation of a diversified economy and a wide range of businesses and industries are represented on the Island. Recent growth areas outside of financial services have been ship registration, ship management and a small, but expanding, film industry.

Although the Island has pursued diversification and has welcomed a wide range of economic developments, it is the Financial Services Sector which has provided most of the growth in recent years. Finance is now the largest sector, and has been the highest income earning primary sector of the economy since 1972. The figure of 37% of GDP understates the importance of the sector to the Island as parts of other sectors, notably professional and scientific services, act in support of the finance sector, providing legal, accountancy and other services.

The origins of the Financial Services Sector on the Island may be traced back to 1961 when certain executive powers were transferred from the Lieutenant Governor to the then Finance Board (now the Treasury). One of the first actions taken was the abolition of surtax on personal incomes. The standard rate of income tax was also reduced, in 1962, from 22.5% to 21.25%. There subsequently began to develop a professional financial services infrastructure to assist in the investment management and planning of personal wealth.

Finance, steadily growing into an important industry, was given a particular boost in 1972 with the rescheduling of the Sterling Area which restricted the holding of Sterling outside the United Kingdom. A further advancement was the abolition of exchange controls in 1979. But a deep recession in the early nineteen eighties coincided with difficulties affecting the Island's banking structure (most particularly the collapse of the Savings and Investment Bank); difficulties which were to lead to the establishment of the Financial Supervision Commission in July, 1983, and an immediate overhaul of the licensing requirements and regulatory system for deposit-taking institutions. The Commission originally regulated both deposit-taking institutions and insurance businesses and then later investment business. A separate Insurance Authority to supervise and regulate the insurance industry was established in 1986. This separate Authority has since evolved into the Insurance and Pensions Authority.

The economy recovered strongly from the mid-1980s onwards as the United Kingdom emerged from recession, as world financial markets were gradually liberalised, and as personal and corporate awareness in respect of financial methods and

instruments grew. Reinforcing these favourable external factors, the Island Government embarked upon a review of its legislative and fiscal framework aimed at attracting direct investment, coinciding with marketing and promotion drives for new residents, and manufacturing and financial services investment. There were major innovations with the establishing of exempt company status initially for insurance companies (1981) but later extended (1984), the widening of the appeal of the Shipping Register (1984 and 1991), the lowering of the standard rate of personal income tax to 15% and a top rate of 20%, the extension of commercial tax allowances, provisions for managed banks, and others.

The 1980s to date have seen a gradual increase in the dominance of the financial services sector. Notable initiatives in the 1990s have included tax exemption for certain classes of partnerships, the International Business Act, a new class of collective investment scheme for professional investors, legislation for Limited Liability Companies and the facility to permit the transfer of domicile of companies.

*Reasons for Business*

There will be various reasons for establishing financial businesses on the Isle of Man, but there is a range of attractions which will influence individual businesses. An attractive fiscal environment is central. However, other features which are influential are:

(a) political and economic stability;

(b) reputation for quality business;

(c) established regulatory standards;

(d) English language;

(e) favourable time zone;

(f) cost-effective business environment;

(g) good external communications;

(h) broadly based and skilled professional support;

(i) Government policy conducive to economic growth;

(j) attractive quality of life;

(k) legal system based on English common law.

*Individual Business Areas*

The Financial Services Sector on the Island, although small in global terms, is diverse and comprises a range of compatible and inter-related business areas. These may be categorised as follows:

*(a) Banks and Building Societies*

There are 65 banks and 3 building societies licensed to conduct their business on the Isle of Man. The banks include the major United Kingdom clearers, as well as Irish, American, European, Indian and Middle Eastern Institutions. Between them, they employ 1,781 people.

The nature of the Island's banking business is largely deposit taking from ex-patriate and foreign depositors, in addition to a range of financial services, including fund management, in keeping with the international trend for institutions to develop diversified, multi-business banking operations. Monies are generally redeposited on an inter bank basis back to London, or the Channel Islands. In this way, Isle of Man generated business brings significant advantage to London.

The Isle of Man is not party to the EU "passporting" arrangements and therefore makes individual decisions on each licensing application received.

*(b) Bureaux de Change*

Licensing policy does not extend to Bureaux de Change and, therefore, the Isle of Man does not have independent Bureaux. There is one Bureau de Change office within a travel agents because it is covered by the HSBC banking licence of its parent.

*(c) Collective Investment Schemes and the Fund Management Industry*

The Financial Supervision Act 1988 defines two main classifications of open-ended Collective Investment Scheme which may be established in the Island. Authorised and Restricted Schemes of which there are two sub-categories - exempt restricted schemes and Professional Investor funds.

The Isle of Man is a designated territory for the purpose of the United Kingdom Financial Services Act 1988. This status was granted following an evaluation of the Isle of Man regulatory regime regarding Schemes by HM Treasury who assessed that the level of protection afforded to investors in Isle of Man authorised schemes is equivalent to that in the United Kingdom. Investments in Isle of Man authorised schemes are protected by the Authorised Collective Investment Schemes (Compensation) Regulations 1988. Qualifying Isle of Man authorised schemes are, therefore, eligible for "fast track" recognition and direct promotion to the United Kingdom general public.

Currently there are 16 authorised and 85 restricted schemes established in the Isle of Man, with 23 licensed fund managers and 5 third party fund administrators.

Funds under management by regulated entities in the authorised, restricted and exempt restricted schemes total, as at 31st March, 1998, 7.5 billion. It should be noted that other jurisdictions include in their statistics closed ended companies (investment trusts) and non local funds to which, for example, investment management or advice services are provided. Such companies, as well as Isle of Man Professional Investor Funds and exempt restricted schemes administered by non-licenceholders, are not included in the Island's statistics.

The Island is, therefore, a much more significant centre for fund management than simple statistical comparison would suggest.

*(d) Investment Businesses*

The Investment Business Act 1991 encompasses all investment activity relating to dealing, arranging deals, giving or offering advice to investors or potential investors or managing investments in much the same way as the Financial Services Act in the United Kingdom.

In order to address the nature of the international business, the Investment Business Act goes several steps further than the United Kingdom Act in terms of its reach. A particular feature of the Investment Business Act which is different to the Financial Services Act is that all Isle of Man incorporated companies and all foreign companies "holding out" from the Isle of Man - no matter where in the world they are carrying out their business, must be licensed by the Financial Supervision Commission if they are conducting investment business. Accordingly, the reach of the Act extends to all those engaged in investment business in, on or from the Isle of Man.

Additionally, 35 banks undertake investment business and this activity is covered by their banking licence although they are still compliance-tested by investment business specialist regulatory staff.

The final category of persons carrying out investment business are the lawyers and accountants who, in the same way as in the United Kingdom, are authorised to do so by their respective professional institutions. The Institute of Chartered Accountants in England and Wales has authorised 4 Isle of Man based firms, the Law Society of England and Wales, a further 4 and the Isle of Man Law Society, 24.

*(e) Life Assurance*

The Isle of Man has 15 authorised life assurance companies. These companies are incorporated and managed and controlled on the Island. The majority of them are subsidiaries of very large United Kingdom life assurance and investment groups. They provide life assurance-based investment products to international investors around the world.

The first such company was established on the Island in 1977 and the sector has grown steadily since that time. Originally, the companies sold policies predominantly to high net worth British expatriates working in the Middle and Far East but that customer base has since diversified to policyholders (British and foreign nationals) all over the world. There are now approximately 1800 people directly employed on the Island by these companies with some 7 billions of policyholders' funds under management. Annual premium income for 1997 was approximately 1.5 billion.

*(f) Captive and Other Insurance*

There are currently 167 captive insurance companies based on the Isle of Man. These companies are incorporated, managed and controlled on the Island. Typically, they are subsidiaries of major industrial organisations around the world and are set up as dedicated insurance vehicles to help those organisations manage their insurance and risk management programmes more efficiently. They do not employ their own staff but are usually managed on the Island by specialist firms of insurance managers. These managers tend to be subsidiaries of some of the world's largest insurance, insurance broking and risk management companies.

The first captive was established on the Island in 1981 and the market experienced particularly strong periods of growth during the mid 1980s and early 1990s when conditions in the world insurance markets were particularly conducive to the formation of captives (high commercial insurance rates and limited availability of cover for some classes). This coincided with the strengthening of the Island's insurance legislation and the creation of a supervisory framework which made it a credible international centre for insurance business.

In the early years of the Isle of Man's development as an insurance centre, the captives established tended to be subsidiaries of United Kingdom companies but, in recent times, although the United Kingdom is still a very important market for the Island, there have been captives formed by companies in many other countries. Total premium income of these companies in 1997 was approximately 900 millions.

In addition to captive insurers, the Isle of Man also has a small number of specialist general insurers and reinsurers.

The Isle of Man also has a number of branches of United Kingdom-authorised insurance companies. Most of these have been established for many years and their principal purpose is to serve the domestic market on the Isle of Man, in contrast to the international life companies and captives, whose markets and risks are overseas.

*(g) Pension Schemes*

The pensions market on the Isle of Man currently comprises several different parts. Firstly, there are schemes established by local and other companies to serve their Manx employees and sometimes employees working further afield. Such schemes may be insurance-based with the business written by companies locally or elsewhere (usually the United Kingdom) or may be trust-based. Secondly, there is also a substantial volume of personal pensions and retirement planning business written by the authorised life assurance companies described above or the branches of United Kingdom companies based on the Island.

A major recent initiative of the Manx Treasury, through the offices of the Insurance and Pensions Authority, involves the examination of the existing arrangements for the supervision of pensions schemes on the Isle of Man and the introduction of a regulatory regime for those areas not currently subject to regulation, to ensure the security of such arrangements both for Manx residents and members of Isle of Man pension schemes, wherever they reside and work.

A Pensions Bill is scheduled for introduction into Tynwald later this year.

*(h) Other Finance Business*

The Isle of Man is a major centre for company registrations and company services. The Island also has a significant trusts sector. Later Chapters give details.

### 3.4 Geographic Distribution of Financial Business

The Isle of Man Government has only limited information on the geographic distribution of the financial business transacted in or from the Island. The data that is available is summarised in the chart below:

| | *Deposit taking Liabilities (bn)* | *Assets (bn)* |
|---|---|---|
| **Non bank** | | |
| Isle of Man | 4.27 | 0.92 |
| Other Crown Territories | 0.19 | 0.09 |
| United Kingdom | 4.41 | 0.17 |
| Other EU countries | 2.00 | |
| North America | 0.63 | |
| Rest of the world | 3.92 | 1.65 |
| Total non-bank | 15.42 | 2.83 |
| **Inter bank** | | |
| Isle of Man | 1.28 | 0.12 |
| Other Crown Territories | 0.08 | 1.59 |
| United Kingdom | 0.37 | 10.12 |
| Rest of the world | 1.04 | 3.07 |
| Total inter-bank | 2.77 | 14.90 |
| **Other** | **1.11** | **1.57** |
| **Total** | **19.30** | **19.30** |

What the data do show is the role that the Island performs in channelling investment into the United Kingdom.

In addition, funds under management are estimated to exceed 16 billion, much of which is invested in, or through, the City of London.

There is in the Government's legislative programme a Statistics Bill. This Bill is to be introduced in the next legislative session and will facilitate the collection of additional economic data.

### 3.5 Importance of the Financial Services Sector

The Island has no significant natural physical resources beyond the wild beauty of its land and seascapes, and for much economic activity, its relative isolation and the associated transportation costs are disadvantages for businesses. As is shown by the data above, the strength of the Financial Services Sector is crucial to the economic and social welfare of the Island. It is, by a significant margin, the largest component of the Island's diversified economy, providing income, particularly from external sources, wealth and employment. Its growth is the principal reason for the influx of economically active young people, particularly qualified people of Manx origin, who have boosted the Island's population numbers and have improved the age profile of the population. Government's revenues and public services are heavily dependent on the profits and incomes generated by the Financial Services Sector.

From the United Kingdom's point of view, the Financial Services industry has an importance which goes beyond ensuring the continued viability and self sufficiency of the Island. The services provided on the Island are used by residents of the United Kingdom and by British citizens abroad. Many of the financial institutions on the Island are branches or subsidiaries of United Kingdom financial institutions so that incomes and profits are remitted to the United Kingdom. The financial services provided on and from the Island are offered world-wide and funds from around the globe are invested through Manx financial institutions. The bulk of these funds, from whatever national origin, are channelled through the City of London, helping to sustain the volume of business transacted by British institutions. Best estimates suggest that some 6 bn more funds are invested into the United Kingdom by the Island's deposit takers than are sourced from there.

The Island is also a source of employment to United Kingdom citizens as most of the immigrants into the Island are persons who sustain the growth of the financial services industry and come from the United Kingdom. The ease of movement of persons between the United Kingdom and the Isle of Man means that the Island, subject to work permit arrangements, offers job and career development opportunities to many young people from the United Kingdom interested in working in the finance industry.

# 4 TAXATION

### 4.1 Policies

Public services in the Isle of Man are financed by fees, charges, rents, admissions, etc., with the balance of cost being met by taxation income.

The Isle of Man Government, therefore, levies direct and indirect taxes on its residents and associations only at such levels as are required to finance such public services.

Under Section 9 of the Treasury Act 1985, the Government is required to budget for a surplus of receipts over payments. Other key objectives of the current Budget strategy affecting taxation policy are:

- to increase the level of operating balances
- to increase the level of the Reserve Fund to the equivalent of half of Government's annual revenue funded gross expenditure in the long term and as resources allow
- to increase personal income tax allowances at least in line with inflation
- to take and keep out of the income tax system those on modest incomes
- generally to reduce the impact of income tax from time to time
- to maintain the Customs and Excise Agreement with the United Kingdom

### 4.2 Indirect Taxes

The Isle of Man's indirect taxation system closely follows that of the United Kingdom. The Island has some scope for introducing minor variations but, generally, it levies value added tax and customs and excise duties at the same rates and subject to the same conditions and on the same range of goods and services as the United Kingdom. The Island maintains a Customs and Excise Agreement with Her Majesty's Government which has, in a variety of forms, been in existence for over a century. The Agreement provides both parties with benefits and enables a common customs and fiscal area to exist. There is full co-operation between the two Customs organisations to prevent abuse of the indirect tax and duty systems. Through the Agreement, the Island has access to the European Single Market and has increasingly developed investigation, intelligence and data links with the EU and its members.

### 4.3 Direct Taxes

The Island's income tax system was introduced in 1918. In general, persons who are resident for income tax purposes are liable to income tax on world-wide income; persons who are not resident are liable on any Manx source income. Where the Manx source income falls within either an extra statutory concession, such as approved bank and building society interest, or is covered by the double taxation arrangement with the United Kingdom, payments are made gross and no action is taken to pursue any income tax liability.

There are no capital, inheritance or withholding taxes.

*Individuals*

With effect from 6th April 1998, individuals who are resident are entitled to a personal allowance of 7,070. For a married couple the personal allowances are fully transferable giving a combined allowance of 14,140. In addition, relief is available for interest paid, private pension contributions and nursing expenses together with a few other deductions such as deeds of covenant for charitable donations.

After allowing for the various allowances and reliefs the remaining taxable income is charged to income tax. The first 9,500 (19,000 for a married couple) of taxable income is charged at 15% and the balance at 20%. The high tax thresholds result in 36% of individuals paying no income tax.

Non resident individuals are not entitled to any personal allowances. Income tax at 20% is charged on any income arising in the Island other than those covered by extra statutory concession or falling within the double taxation arrangement with the United Kingdom. Where a liability does arise the Assessor will, in most cases, require the tax to be deducted at source.

*Companies*

*(a) Resident Companies*

A Manx incorporated company is deemed to be resident unless it files a non resident company declaration. That declaration can be challenged if the Assessor has reason to believe that the company is in fact resident. In such circumstances the test is the same as for any foreign incorporated company, namely where the central management and control is exercised. There is no statutory definition of central management and control and therefore case law plays an important part in determining where that is actually carried on. The practice has been to use UK case law as persuasive argument provided it does not clash with any specific legislation or rulings in the Isle of Man.

Companies which are resident in the Island for taxation purposes are, subject to any specific exemptions, liable to income tax on their worldwide income. That is to say any income which arises from any source whatsoever in or out of the Isle of Man. The calculation of the income is determined in accordance with normal accountancy provisions other than where there is a specific provision within the Income Tax Acts covering particular deductions or sources of income.

The normal basis of assessment is the income of the previous year. It has been a long standing practice to accept the twelve month account ending in the previous year as representing the income for that tax year. Special provisions exist in the opening and closing years of a source of income to enable it to be assessed on the income arising in the year.

There are no capital taxes although relief is available for approved capital expenditure such as the acquisition of plant and machinery for trading purposes. The capital allowances regime which exists in the Island is in essence the United Kingdom system in force as at 5th April 1994. The one main difference is that the Island has retained the 100% first year allowance and extended it to specific commercial activities such as agricultural buildings and industrial premises. Relief for tourist premises was introduced long before the United Kingdom legislation came into existence and therefore it is covered by separate provisions. There is a specific incentive for tourist premises which extends relief to a total of 250%.

Any dividends paid by a company are allowed as a deduction in calculating the taxable income of the company. Where the dividend is paid to a non resident the company is required to deduct non resident income tax of 20% and remit it within 14 days to the Income Tax Division.

The remaining taxable income is then charged to income tax at a rate of 20% with double taxation relief being given for any overseas income which has already suffered income tax by deduction at source or otherwise. For fund management companies there is a concessionary rate of income tax of 5% on the net fees which arise from the management of collective investment schemes, other income being charged at 20%.

Trading losses arising out of excess expenditure or capital allowances can be set off against other income or can be carried forward. Group relief provisions exist to enable such losses to be set off against the income of other group companies in a manner similar to that of the United Kingdom.

Failure to comply with the legislation can result in prosecution and/or a tax geared penalty being applied.

*(b) Non-resident companies*

Residence is a taxation concept and can apply to companies which are incorporated in the Isle of Man as well as to companies incorporated elsewhere. For example, a company incorporated in the United Kingdom carrying on business in the Island through a permanent establishment is a non resident company. Equally, a Manx incorporated company which is managed and controlled from outside the Island is also a non resident company.

Manx or foreign incorporated companies managed and controlled outside the Island will be liable to non resident income tax at 20% on any taxable income arising in the Island e.g. trading profits, rental income and dividends. Otherwise, Manx tax does not arise. In addition, a Manx incorporated company will be required to pay non resident company duty of 750. Experience has shown that the activities of such companies are mainly investment holding but they can include any of the normal range of activities carried on by any company anywhere in the world.

*(c) Tax exempt companies*

Manx and foreign incorporated companies which are resident in the Isle of Man for tax purposes may be exempted from a liability to pay income tax provided certain conditions are satisfied. From a taxation aspect the specific requirements are -c the company does not carry on or transact any trade or business which is prescribed e.g. the manufacture or sale of goods on the Island;

- it is not carrying on a licensable activity such as banking or insurance;
- all receipts and income arise outside the Island or from other exempt companies and originate from persons who are not resident in the Island;
- no person resident in the Island has any interest in the company.

In addition to the specific tax issues there are some regulatory requirements such as the need for a resident director and a resident and qualified (or Treasury approved) company secretary. Undertakings and statutory declarations have to be supplied confirming that the provisions of the legislation will be or have been complied with.

The current fee for exempt company status, which has to be by way of annual application, is 400.

*(d) Tax exempt insurance companies*

A resident insurance company can be exempted from income tax on the whole or part of its profits or income provided certain conditions have been satisfied. From a purely taxation perspective, the whole or part of its underwriting profits and losses must arise solely on insurance risks undertaken by the company outside the Island (irrespective of the place of making any agreement in respect of such risks) other than for insurance business carried on with other insurance companies which have also been granted exemption.

*(e) International Companies*

Resident companies, irrespective of where they are incorporated, which satisfy the requirements of the International Business Act may apply to have a rate of tax which is chargeable according to the specific requirements of the company. This can be on a sliding scale up to a maximum of 35% of taxable profits computed along normal income tax lines but subject to a minimum tax charge of 1,200. Once made and agreed, there is no provision which enables a company for that year of assessment to rescind its application or apply for a different rate of tax to be levied. The conditions which have to be met are similar to those for an exempt company.

With few exceptions the provisions of the Income Tax Acts apply e.g. filing of returns, collection of tax, employers requirements, etc. Equally, as with exempt companies, there are some regulatory requirements such as the need for a resident director and a resident and qualified (or Treasury approved) company secretary. Undertakings and declarations have to be supplied confirming that the provisions of the legislation will be or have been complied with.

*(f) Limited Liability Companies*

This is a hybrid entity which has its origin in America. The legislation introduced in the Isle of Man is modelled on that approved by the Internal Revenue Service for the State of Wyoming. In many ways it can be thought of as operating in a similar manner to a limited partnership, except it is incorporated like a company and thus possesses a separate legal entity from its members. In this respect it can be likened to the Scottish form of "limited partnership". It has a life limited to 30 years.

The taxation of the company is also similar to that of a partnership with the profit being allocated to its members who in turn are assessed to income tax according to their residence status (see later item on partnerships). Normal income tax principles apply to the calculation of the taxable income.

An international limited liability company may be tax exempt on a similar basis to the exempt company.

*Partnerships*

*(a) General*

For Manx tax purposes partnerships are not assessed to income tax; it is the partners of the partnership who are assessed. The taxation treatment is therefore dependent upon where the business of the partnership is carried on and where the partners are resident for tax purposes. For example -c a partnership being carried on within the Island will give rise to local source income. A non resident partner will be liable to non resident income tax at 20% on the share of profit whilst a resident partner will be required to declare his or her share on the annual income tax return together with any other income;

- if the business is carried on wholly outside the Isle of Man normal income tax rules will apply in that it will no longer be Manx source income and only resident partners will be liable to Manx income tax on the share of profit.

*(b) Limited Partnership* These are not treated any differently for tax purposes to any other partnership. A limited partner will be liable to income tax on any share of profit which arises in the Isle of Man.

*(c) International Limited Partnerships*

These are very similar to the exempt company in that it is exempt from income tax if it satisfies very similar criteria. There is in addition a requirement to have all the limited partners resident outside the Island although, for regulatory purposes, the general partner must be a corporate body resident in the Island.

*Trusts*

A Trust is not a "person" for income tax purposes and like a partnership is not a taxable entity in its own right. Income arising as the result of a trust will be assessable on the trustees or, if distributed, the beneficiaries. For the purposes of Manx income tax , the expression "Manx trust" includes -

(i) trusts made in the Isle of Man under Manx law that are managed and controlled in the Isle of Man ; and

(ii) foreign trusts that are managed and controlled in the Island.

This can give rise to a number of different taxation scenarios -

(a) a Manx trust in which -

(i) the beneficiaries reside in the Isle of Man; and

(ii) all the income of the trust is distributed each year, the beneficiaries fall to be assessed to income tax on the income received;

(b) a Manx trust in which -

(i) one or more of the beneficiaries reside in the Isle of Man; and

(ii) a part or all of the income for any year is not distributed, the trustees will be liable to tax on the part not distributed and the beneficiaries on the amount that has been distributed;

(c) a Manx trust in which -

(i) the beneficiaries do not reside in the Isle of Man; and

(ii) all the income of the trust arises outside the Island or from "approved" sources in the Island e.g. bank interest,

whether or not the income is distributed no liability to income tax will arise. This enables the income to be accumulated or distributed according to the needs of the trust.

Any Manx trust that gives rise to a liability to income tax in the Isle of Man , either directly on the trustees or indirectly on the beneficiaries, is required to lodge a copy of the trust deed with the Income Tax Division and submit an annual return of income and expenditure.

# 5 FINANCIAL REGULATION, POLICIES AND STRUC

### 5.1 Policy

It is inherent in the Island's approach to the Financial Services Industry that the industry must be reputable and well-regulated. T good reputation of the Island's Financial Services Industry is considered to be essential for the Island's long term success in this f lowest, any instance of failure of regulation would be seen as counter-productive to the Island's external reputation and long-tern be treated, within the Island, as a serious matter.

The Island's policy is, therefore, to regulate its finance industry to international standards and to regularly update its arrangement developments. U.K. legislation and regimes of regulation are highly influential and, although there are significant differences as adapted to suit the Island's requirements, the Island's arrangements are recognisably similar to those applying in the United King

### 5.2 Development of Regulation

Regulating the Financial Services Industry is evolutionary in nature and the Island has constantly sought to improve its regulatio the growth in the Industry, also taking into account developing technology and law and practices elsewhere.

The first of the current generation of dedicated regulatory authorities was created in 1983 when the Financial Supervision Comm following the collapse of the Savings and Investment Bank.

The activity of the Commission's early years focused on introducing Know Your Customer Guidance Notes, Anti-Money Launde closing down smaller or potentially unstable banks, ensuring proper capital adequacy and ring fencing systems were in place. Fo housekeeping period, the Commission's attentions turned to regulating funds and fund managers through the introduction of the Supervision Act 1988. The Act, which lays down structures and standards for Collective Investment Schemes and their manager "gateways" enabling the Commission to communicate effectively with other international regulators, law enforcement bodies, th Treasury and other persons with whom it is essential for the Commission to have comprehensive communication arrangements.

These provisions were largely based on the newly introduced United Kingdom Financial Services Act "gateways" and ensured p communication and co-operation.

With banking and scheme business well ordered, the Commission turned its attentions to introducing the Investment Business A to ensure that those financial services businesses that were not able to rise to the standards newly required in the United Kingdon introduction of the Financial Services Act, were not attracted to the Isle of Man as a jurisdiction of lesser standard. From the earl Commission has conducted robust on-site compliance testing visits as well as the prudential style visit where broader manageme discussed.

In 1993, the Investment Business Amendment Act 1993 was introduced. This significantly increased the Commission's investiga accordingly the Enforcement Division was established with the particular task of policing the perimeter, and taking strong action in breach of the Banking, Investment or Collective Investment Schemes legislation.

The second of the new generation of regulatory authorities is the Insurance and Pensions Authority. It was originally established Authority in 1986 and became the Insurance and Pensions Authority in January, 1997, following the addition to its responsibiliti developing a regulatory framework for pension business.

The Authority has successfully overseen the development of the diverse insurance industry on the Island.

A recent initiative will see the introduction of registration requirements for insurance intermediaries carrying on general busines

and investment intermediaries already regulated by the Financial Supervision Commission). These general insurance intermedia
to register with the Insurance and Pensions Authority under the Insurance Intermediaries (General Business) Act 1996 and to co
criteria, including the requirement to have acceptable professional indemnity insurance. The market comprises some 20 indepen
and a large number of tied agents.

The Pensions Bill, more wide-ranging than the United Kingdom equivalent, is to be introduced later this year, and will give the I
Pensions Authority the legislative framework to regulate pension funds to the same high standard and effectiveness as insurance

An Insolvency Bill is also included in the legislative programme for 1998/99. The policy of the Government is to achieve a sens
existing insolvency provisions, to take account of recent changes in the market place. There is no intention at this time to change
liquidation system, more a fine tuning of the current provisions. A provision to allow corporate recovery procedures to be impler
included in the Bill as a new measure.

The Treasury and Tynwald have both given their support to a full-time office of Official Receiver being established. Provision fo
included in the Bill.

The next major development in relation to the regulation of financial services on the Island will relate to Corporate Service Provi

As in the United Kingdom, there are currently, in the Isle of Man, no restrictions as to who can form and administer companies.
November, 1997, a consultative paper was issued by the Council of Ministers entitled "A Consultative Paper on the Licensing of
Providers". The consultative paper proposed the licensing of all persons and/or bodies corporate who:

(a) form or sell companies by way of business;

(b) provide a registered office or accommodation address by way of business;

(c) provide directors (themselves or others) by way of business.

Further particulars on this initiative are shown in Section 12.

This is seen as the first of a series of developments to which the Council of Ministers has publicly committed itself and which wi
additional regulation to the company and trust areas of business (see Section 17 below for the background to the Council of Min
April, 1992, which contained the public commitment).

In furtherance of this broad strategy, the Isle of Man Treasury established a Working Party in March, 1998, to examine the super
in the Isle of Man and to look at ways in which existing corporate law may be more effectively enforced. The Working Party has
times since March and on 18th June, considered a report based on its preliminary findings. The findings were categorised into ar
company registry issues, company supervision issues, domestic and international solvency issues and a number of other points re
to measures to wind up in the public interest and provisions for disqualification of delinquent directors.

The principal finding of the Working Party was that there was a clear need to establish a Companies Supervision Commission an
has produced a report for submission to the Treasury and consideration by the Council of Ministers. It is anticipated that the dev
Commission will go hand in hand with the introduction of the regulatory system for Corporate Service Providers and that both w
near future.

This initiative can be shown to have wide political support. At the April 1998 sitting, Tynwald resolved:

> "That Tynwald is of the opinion that the legislation relating to companies should be reviewed to ensure that companies
> Island or incorporated elsewhere and registered under Part XI of the Companies Act 1931 are controlled and managed i
> principles and procedures which are consistent with the best interests of the Island's economy and its reputation."

The area of Trust regulation will be addressed subsequently as part of the broad strategy of reviewing and extending regulatory a
order of priority, to company service providers, companies and trusts.

The Isle of Man Government has established high standards with its legislation and practices in respect of the regulatory authorit
responsibilities allocated since 1983. The same rigorous approach and pursuit of quality is driving the further regulatory initiativ
process or in prospect.

### 5.3 Agencies Involved in the Regulation and Supervision of the Financial Services Sector

There are a number of agencies of the Isle of Man Government who have roles to play in the regulation and supervision of the Fi Sector. Of these, the most important are the Financial Supervision Commission and the Insurance and Pensions Authority.

*(a) The Financial Supervision Commission*

The Financial Supervision Commission is an independent Statutory Board. It is directed by seven Commissioners, of whom six a from within the Island and are non-executive; these include a Chairman, who is a member of Treasury. The only Executive Com Commission's Chief Executive. Commissioners are appointed by Treasury subject to the approval of Tynwald. Commissioners m financial sector interests - for example, non executive directorships of licenceholders - but must declare their interests in advance and absent themselves from any Commission debate where there may be a conflict of interest.

Currently the Commissioners are all residents of the Isle of Man, selected for their professional experience of the Island as an int centre. Their expertise includes previous directorships of major banks and telecommunications organisations, a clearing bank's tr major private bank, and senior management experience of collective investment schemes, the building society industry, informat the financial services sector, mainstream clearing banking together with expertise in economics and financial services marketing. Commissioners are professionally qualified in areas of banking, economics, law and investment business management.

The Commissioners sit, formally, every two weeks. The Commission considers a wide range of issues, from policy matters to in decisions.

The Commission's costs are primarily met from fees paid by institutions and schemes which it licences and authorises. In 1998/9 Commission's estimated costs are 1.56 million and its income 1.1 million.

The Commission has, since its inception in 1983, interpreted and published its remit as follows:

> (a) The purpose of having a banking and financial centre is to provide measurable economic benefits to the Island;
>
> (b) The Isle of Man has nothing to gain from permitting activities or institutions which provide shelter for or facilitate t criminals, and
>
> (c) Institutions established on the Isle of Man and their customers will benefit from standards of licensing and supervisi best practice and are acceptable to supervisory authorities in other jurisdictions.

The main functions of the Commission include:

> (i) the licensing and supervision of banking institutions under the Banking Acts of 1975 to 1998;
>
> (ii) the licensing and supervision of investment businesses under the Investment Business Acts 1991-93;
>
> (iii) the authorisation, recognition and regulation of collective investment schemes under the Financial Supervision Act
>
> (iv) the authorisation and supervision of building societies under the Building Societies Act 1986; and
>
> (v) various miscellaneous functions under the Companies Acts 1931-92

The staff of the Commission numbers 23, of whom 15 are professional regulators, 4 administration staff whose responsibility inc information systems, and 4 who provide secretarial services. The Commission encourages employees to develop their profession qualifications and, accordingly, staff hold a variety of relevant qualifications including memberships of the Institute of Bankers, I Securities Institute, the Institute of Chartered Secretaries and the Institute of Certified Accountants. Of the professional regulator international employment experience and all have international market experience gained through their regulatory activities, inte and mutual assistance visits.

The Commission is divided into four divisions:

*(1) Supervision*

Supervision delivers a "one stop shop" FSA style integrated regulatory operation, covering banks, building societies, investment businesses, collective investment schemes and credit unions.

The Supervision Division is committed to the concept of approaching regulation in a manner that recognises the conglomerate na licenceholders and therefore multi-skilled teams carry out the on-site compliance testing visits.

*(2) Administration*

Administration is responsible for financial controls, IT systems and Human Resources issues, as well as providing the Secretaria Chief Executive's Office and the Commission itself.

*(3) Policy and Special Projects*

The role of Policy is Commission wide and is focused on ensuring the Commission's operational divisions continue to deliver "le supervision by evaluating international developments and following a programme of re-evaluation of existing policies and practi Policy and Special Projects carries out Disciplinary Actions against licence-holders where a compliance matter arising from Sup takes a more serious turn.

The Commission's policy in respect of disciplinary action is robust. Work has resulted in:

(i) 5 notices under Section 10 of the Investment Business Act have been issued. This has resulted in 5 individuals being industry because their conduct has fallen below acceptable standards.

(ii) 2 petitions to court to wind up licenceholders in the public interest, plus

(iii) 1 voluntary cessation of a licenceholder's activity following an investigation.

These various procedures have full rights of appeal and, on each occasion, the Commission's decisions, or petition, has been uph

*(4) Enforcement*

The Enforcement division has, as its primary function, the responsibility of investigating and taking appropriate action against th investment, banking or scheme business without the appropriate authorisation.

Additionally, the Division has prophylactic and preventative roles which it delivers through, for example, collation of intelligenc trends, active monitoring, close liaison with other international regulatory and law enforcement bodies and through seeking to ec means of articles, lectures and conferences.

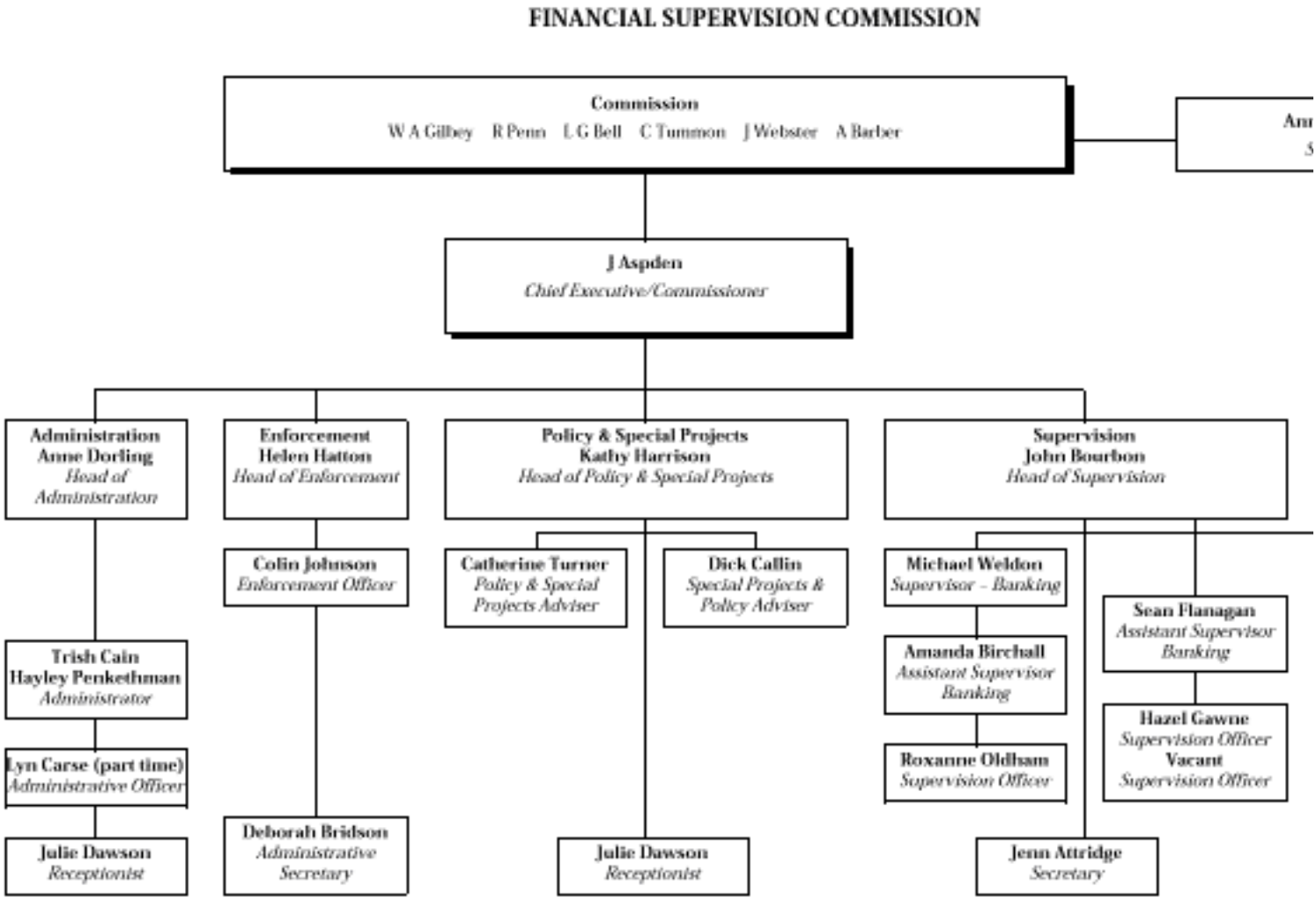
In terms of results, the Division's work has taken 45 matters to court, secured 45 victories, including 19 petitions to wind up in th and 2 Restitution Orders. Over 11 million has been returned to investors from over 14 jurisdictions.

The work of the Division is unusual because, so far as the Commission is aware, no other offshore jurisdiction delivers an equiva

The Commission attaches much importance to its international memberships - for example, the Commission is a member of the I Organisation of Securities Commissioners (IOSCO), the Enlarged Contact Group (ECG) on collective investment schemes, and Group of Banking Supervisors (OGBS) established by the Basle Committee on Banking Supervision.

The Financial Supervision Commission has entered into memorandums of understanding with the Investment Managers Regulat the Law Society of England and Wales, the Institute of Chartered Accountants for England and Wales, the Isle of Man Law Soci Securities and Futures Authority, the Australian Securities Commission, the London Stock Exchange, the U.K. Securities and In FIMBRA and LAUTRO. Other memoranda are under discussion.

The Commission publishes Guides which fully explain its licensing policy and includes as Appendices to each guide, all relevan applicable to each different type of licenceholder.



*(b) The Insurance and Pensions Authority*

The Insurance and Pensions Authority is a Statutory Board established under the Insurance Act 1986 and it has responsibility for the regulation and development of the insurance and pensions sector in the Isle of Man. Specifically, it is responsible for the authorisation and ongoing supervision of Isle of Man companies carrying on insurance business in or from the Isle of Man and for companies incorporated elsewhere which carry on insurance business on the Island. Following the introduction of the proposed pensions legislation, it will also have responsibility for regulating pension schemes and those persons who conduct and administer pensions business on the Island.

The Authority is directly responsible, within its statutory remit, for ensuring the administration of the Insurance Act 1986. The Authority, subject to the approval of the Treasury, sets and administers its own budget, appoints according to its own terms and conditions, its own staff and decides, without Government interference, how to best manage its affairs to ensure that its statutory role is fulfilled.

The Authority may be subjected to such change as Tynwald, reflecting democratic process, may consider appropriate.

The Members of the Insurance and Pensions Authority are appointed by the Treasury, subject to the approval of Tynwald. They comprise a chairman (who must be a Member of Tynwald) and at least two other persons. Currently, there are four members of the Insurance and Pensions Authority in addition to the Chairman. One of these is the Chief Executive of the Insurance and Pensions Authority. All the members have substantial experience of the international insurance industry, and include an actuary and an accountant. Two of the members are not resident on the Isle of Man and travel to it from the United Kingdom for the Insurance and Pensions Authority's regular meetings.

Members of the Authority may have other interests connected with the insurance sector on the Isle of Man, for example non-executive directorships, but must declare their interests in advance and take no part in any decisions of the Authority where there may be a conflict of interest.

The Insurance and Pensions Authority is a policy making body and it, therefore, delegates much of its responsibility on a day-to- day basis to the holder of the office known under the Insurance Act 1986 as the Insurance Supervisor. The Insurance Supervisor is also the chief executive officer of the Insurance and Pensions Authority.

The Authority meets, on average, every six to eight weeks.

The Isle of Man was the first jurisdiction to receive Accreditation under the United Kingdom's Financial Services Act (Section 130) as a Designated Territory. This acceptance by the United Kingdom of the quality of the Authority's regulatory framework allows the Island's insurers to sell in and through the United Kingdom.

The Island's insurance market place has a close and natural affinity with the United Kingdom and other international jurisdictions, particularly through ultimate beneficial ownership, shareholder, reinsurance, investment management and other links. Relationships with the relevant regulatory authorities are essential and these have been fostered over many years. In a United Kingdom context, typically, given the nature of the Authority's role and its designation, these bodies comprise:

(i) The Insurance Directorate of HM Treasury;

(ii) Formerly the PIA and the Building Societies Commission, but now the new regulator.

Meetings to discuss matters of regulatory concern and interest are a normal behaviour pattern.

The Insurance and Pensions Authority's role is regulatory. It is to administer the Insurance Act 1986. Within that, it has established the following prime objectives - its "Mission Statement":

*"1. For the Authority:*

*To create, for the Insurance and Pensions Authority, a decision making and operational structure that is pragmatic and manageable; one in which it retains policy decision making but operates on the basis of delegated decision making to its Executive.*

*2. For the Regulatory Environment:*

*To provide a regulatory environment that is compatible with international standards*

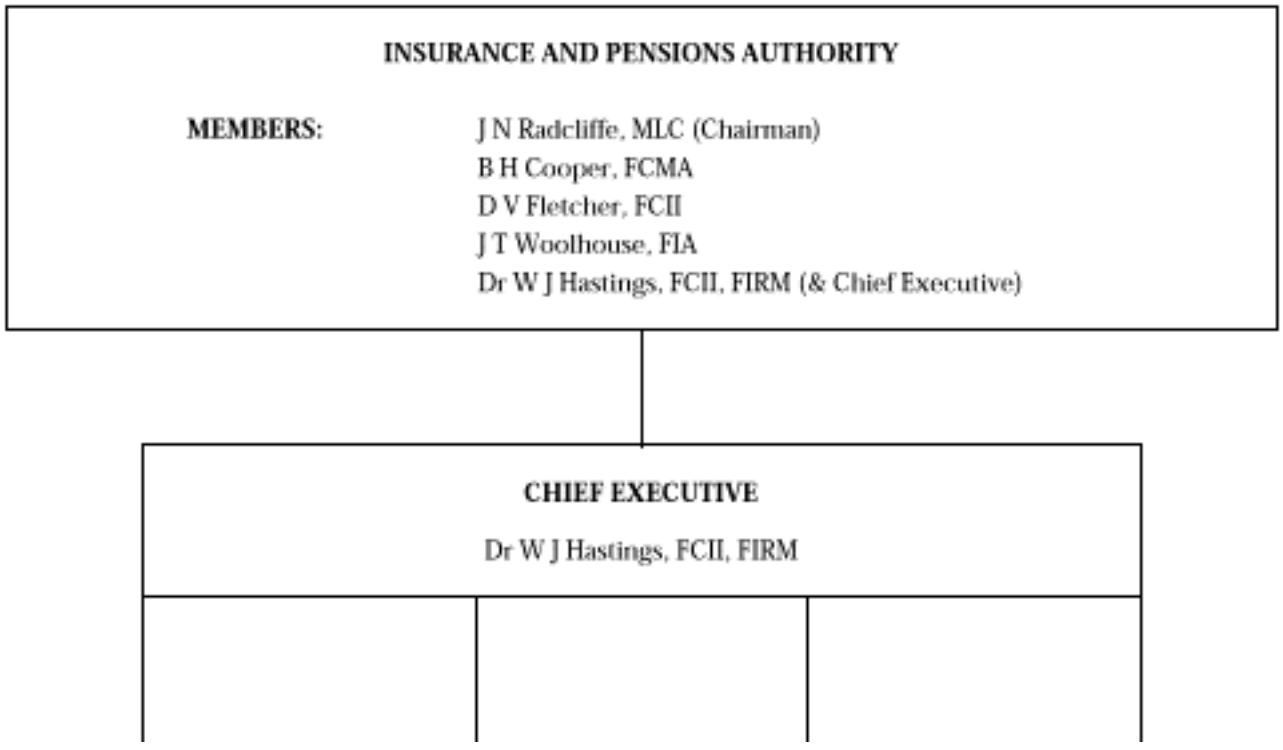
*3. For the Administrative Environment:*

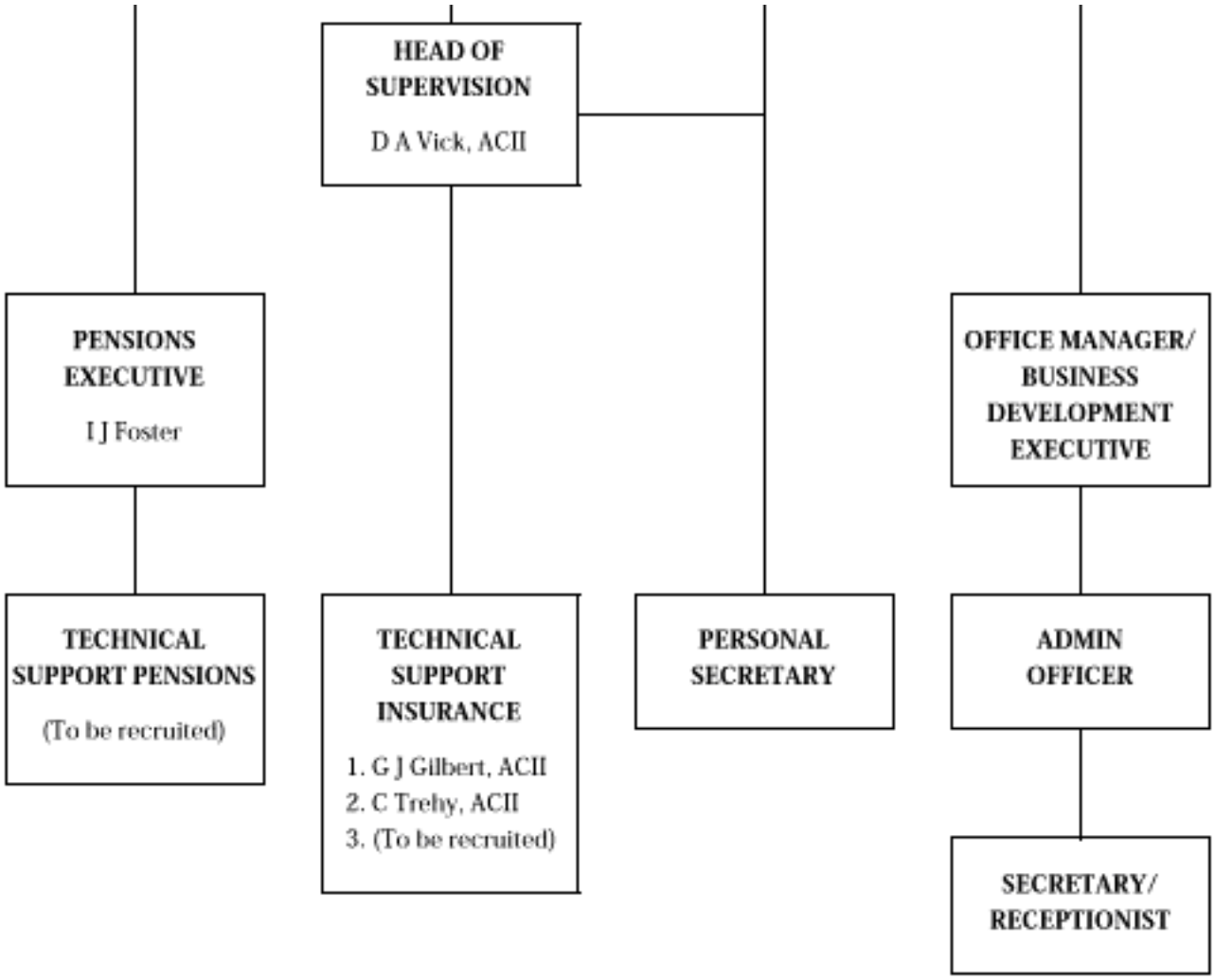
*To ensure an administration system that is technologically advanced and provides a cost effective support to the regulatory functions falling within the Insurance and Pensions Authority's remit."*

The Insurance and Pensions Authority currently has an establishment of nine full- time staff. This comprises the Chief Executive and five other regulatory staff (one of whom is in the process of being recruited); a member of staff responsible for general business development, public relations activities and office services; and two administrative support staff. The Authority is committed to recruiting additional staff as they become necessary.

The Authority's establishment is supported by appropriate data processing systems which comprise, amongst other facilities, a relational data base and an analytical reporting mechanism for all businesses it authorises and supervises. The system is there to assist staff in the execution of the statutory mandate of the Authority. The system helps to highlight potential problems and therefore assists in the prioritisation of regulatory action that may be decided upon.

The Insurance and Pensions Authority's projected expenditure for the financial year 1998/99 is 718,800, of which some 565,000 will be recovered in licence fees.






*(c) Other Agencies*

Although not regulators, the Attorney General's Chambers, the Police, the Companies Registry, Customs and Excise and the Income Tax Division have important roles to play in investigation and enforcement.

### 5.4 Regulatory Legislation and Supervision

This section reviews the regulation and supervision of the core financial services of banking, building societies, collective investment schemes, fund management, investment businesses, insurance and pensions.

*(a) Financial Supervision Commission*

The Financial Supervision Commission is responsible for regulating banks, building societies and investment businesses, collective investment schemes and fund managers that operate in or from the Isle of Man. It was established in 1983 with the remit:

> *"To take such steps as appear to it (FSC) to be necessary or expedient for the effective supervision of the private financial and commercial sector in the Island"*

In fulfilling its remit, the Commission has adopted the following Mission Statement:

> *"To promote and secure high standards of integrity, solvency and competence within the Manx financial services industry, in order to engender an environment in which financial institutions provide quality products and services for the economic benefit of the Island*

*To fulfil its Mission, the Commission will*

*(a) set and publish standards designed to:*

*(i) protect investors' and depositors' interests;*

*(ii) promote the financial stability of financial institutions;*

*(iii) promote the highest standards of competence and professional qualifications;*

*(iv) protect the integrity of the financial community;*

*(v) protect the reputation of the Isle of Man.*

*(b) monitor compliance with the standards, taking prompt action where necessary.*

*(c) take steps to investigate and, where appropriate, prosecute those engaged in unlicensed investment or banking business.*

*(d) co-operate with other regulators and play a full part in the development of international regulatory standards.*

*(e) assist Government in reviewing the promoting legislation relevant to the Financial Services Industry.*

*(f) seek the participation and support of the industry in achieving its objective.*"

Effective regulation is ensured through publishing a clear licensing policy, focusing on sound initial licensing decisions - no amount of regulation can make up for a poor initial licensing decision - followed up by thorough compliance testing of adherence to codes of conduct and standards.

More detail about the Commission's approach to the regulation of particular parts of the financial services industry is given in Sections 6 and 7.

*(b) Insurance and Pensions Authority*

The basic regulatory framework for insurance business is set out in the Insurance Act 1986 (as amended)("the Act") and the more detailed requirements are included in regulations made under the Act. The Act states that any person carrying on insurance business in or from the Isle of Man (and in respect of an Isle of Man incorporated company, anywhere in the world) must be authorised to do so by the Insurance and Pensions Authority, unless exempted by the Act or the regulations. Many of the principles on which the system of supervision and its requirements are based are similar to those adopted in the United Kingdom and other major financial centres.

The Insurance and Pensions Authority considers that it is an important part of its role to examine, on an ongoing basis, the effectiveness of the legislation to ensure that the interests of the policyholders and of the Isle of Man are protected and enhanced. To this end, a number of changes have been made to the legislation since it was originally put in place (for example, the solvency margin requirement for life companies was increased and the amount of information required to be filed was also increased).

The work which is currently being undertaken in respect of pensions is another example of this role.

Not only are the requirements set out in primary and secondary legislation but also in a set of Guidance Notes. It is therein that policy is clarified, for example, what the Authority considers to constitute "Management" in the Island; what its view is on the matter of discretionary trusts; what, for the purposes of an application must comprise the constituent documents.

Most activity associated with the regulation and administration is conducted off-site. All documentation, Authority meetings and formal regulatory meetings are normally held within the Authority's offices although supervisory meetings may be held at the offices of the company, particularly in respect of life assurance companies.

The Authority uses external professional advisers as and when necessary. Typically, these would be lawyers, accountants, actuaries, systems specialists, insurance and pension specialists. In all instances, these are seen as complementary. Additionally, in an enforcement context, law enforcement agencies will be utilised.

In particular, all life insurer returns, in addition to being reviewed internally, are referred to a United Kingdom firm of consulting actuaries, Watson Wyatt, for actuarial review. Watsons report, certainly annually, on a case by case basis, and sometimes more frequently depending on circumstances. No life insurer is authorised without actuarial review of the business proposals made.

The Insurance and Pensions Authority is a member of the International Association of Insurance Supervisors and is also an active founding member of the Cross-Border Group of Insurance Supervisors, thereby bringing its weight to progressing regulatory standards around the world.

More detail about the Authority's approach to regulation is given in Section 8.

### 5.5 Investor Protection

Protection of investors and depositors, both on and off the Island, is at the heart of the Government's regulatory policy. The Government is very aware that the majority of the Island's customers do not live on the Island itself and therefore their interests may not most immediately be represented through the normal Parliamentary/constituency system. However, it is to the credit of the Island's regulatory system that investor and depositor protection for non-Manx resident customers, as much as for residents, is enshrined in legislation and in the Island's regulatory policy. These protections are derived from 3 main areas:

1. Firstly, as described under 5.4, through the strong initial licensing test, and by keeping "greenfield site" and low competence operations out of the jurisdiction.

2. Once licensed, the investor/depositor protection is further enhanced by active compliance testing, ensuring solvency is properly monitored and compliance with, for example, Client Money rules.

3. If, despite all measures under 1 or 2, a bank, building society or scheme collapses, the Isle of Man offers statutory "safety net" protection via:

*(a) Banks/Building Societies*

The Depositors Compensation Scheme (Banking Business [Compensation of Depositors] Regulations 1991) offers 75% of the eligible protected deposit liability up to a maximum of 15,000 to any one depositor. Whilst the Isle of Man scheme is similar to the United Kingdom provisions, Island depositors are additionally protected, above United Kingdom provision, in one respect, namely that the Isle of Man Scheme extends to all currencies whereas the United Kingdom scheme is applicable only to Sterling deposits. The Depositors Compensation Scheme is a fund to which contributions are levied from licenceholders if required.

*(b) Collective Investment Schemes*

For those investors who place their monies in Authorised Schemes, protection, in the event of disaster, can be taken from the Authorised Collective Investment Schemes (Compensation) Regulations of 1988. These provide for a fund, financed by contributions from the regulated institutions.

Similarly, this protection has United Kingdom parity and was successfully evaluated by HM Treasury in its examination of the Isle of Man regulatory regime prior to gaining Designated Territory Status and was again evaluated as satisfactory in a recent follow up review.

It is thought that the Isle of Man is the only offshore jurisdiction to offer a Depositors Compensation Scheme as well as a dedicated enforcement team.

*(c) Insurance Companies*

The Isle of Man has a statutory policyholders compensation scheme for life assurance companies. The scheme was introduced in 1988 (initially as a voluntary arrangement pending appropriate legislation) and is now constituted under the Life Assurance (Compensation of Policyholders) Regulations 1991.

It is designed to provide benefits for policyholders of up to 90% of the actuarially-assessed liabilities of any life company which becomes unable to meet its obligations. Unlike a number of other schemes in other jurisdictions, there is no upper monetary limit on the amount of compensation which can be paid to an individual protected policyholder.

In the event of it being activated, the scheme would be financed by a levy on the remaining life assurance companies which are part of it, up to a maximum of 2% of the actuarial liabilities. The Insurance and Pensions Authority is the designated scheme manager.

Since the scheme was introduced, it has not been called into operation.

# 6 BANKING BUSINESS

### 6.1 Policy

The activities of banks and deposit-takers are closely supervised and controlled in the Isle of Man. The Isle of Man Government and the Financial Supervision Commission are well aware of the political, economic and social damage which can occur as the result of a bank failure. Furthermore, because of the possibility of damage spreading through a reduction of confidence, banking supervision should aim to be a seamless robe. It is this principle which underlies the International Concordat on banking supervision drawn up by the Basle Supervisors' Committee, to which the Isle of Man is a subscriber. This provides for the sharing of responsibilities between supervisory authorities.

The licensing policy for banks and deposit taking institutions is based on an evaluation of quality encompassing a wide variety of criteria, not least of which is culture. The policy is not based solely on a world ranking system, though it does take account of IBCA ratings and other similar information.

The Commission does not license privately owned banks, nor any licenceholders whose ownership rests ultimately in a discretionary Trust. All licenceholders are subject to a stringent initial and ongoing "fit and proper" test which encompasses examining institutional and senior management's competence, integrity and solvency.

The Commission's licensing policy does not permit "greenfield site" or start up operations. All applicants have to satisfy the Commission that they have a satisfactory track record in acceptable jurisdictions. Additionally, the licensing policy does not admit licenceholders unless the Commission can be satisfied that the parent company operates in a jurisdiction which is in compliance with the recommendations of the Basle Committee on Banking Supervisors and that the Commission can establish satisfactory inter-regulatory relationships with the home regulatory authority.

The Isle of Man is not party to the EU "passporting" arrangements and therefore makes individual decisions on each licensing application received.

### 6.2 Coverage

In the Isle of Man, banking business is defined in section 1 (1) of the Banking Act 1998 as being " ..... a business which includes the carrying on of any one of the following activities:

*(a) the receipt of deposits;*

*(b) the payment and collection of cheques*."

This is a deliberately wide definition which may encompass persons whose business may technically fall within the definition but who clearly are not intended to be caught by the definition. The Commission, therefore, has power under section 1 (3) of the Banking Act 1998 to declare in writing that the business is not to be treated, for the purposes of the Act, as banking business.

Conversely there is power, again under section 1 (3) of the Act, for the Commission to declare that a business is to be treated as banking business and on the making of such a declaration the Act shall apply accordingly to that person's business. This power might be used, for example, to ensure proper supervision of the holding companies of banks licensed in other jurisdictions. Under section 1 (4) of the Act, the Treasury may by order modify the definition of banking business in section 1 (1) of the Act.

Additionally, there is the definition of banking business under section 2 (2) of the Banking Act. This sub-section provides

that a person shall be treated as carrying on a banking business:

> *"(a) in the Island if that person carries on a banking business outside the Island and establishes a representative office in the Island; or*
>
> *(b) from the Island if that person -*
>
> > *(i) is a company incorporated in the Island under the Companies Acts 1931 to 1993; or*
> >
> > *(ii) is a body corporate incorporated outside the Island which is registered under part XI of the Companies Act 1931,*
>
> *and carries on or holds itself out as carrying on a banking business outside the Island, whether on its own behalf or on behalf of any other person in or outside the Island*."

In sub-section 2 (a), " representative office" means any office which in any way appertains to any banking business carried on by a person, other than an office from which that person actually carries on that business. These provisions encompass all Isle of Man incorporated companies, whether resident or non-resident, and all foreign companies having a place of business on the Island which carry on banking business in or from the Island or abroad.

The establishment on the Isle of Man of holding companies for banks licensed in other jurisdictions will also require a licence under the Banking Act and the activity of managing in the Isle of Man banks licensed in other jurisdictions is dealt with by Section 3 of the Banking Act.

The Commission may issue two types of banking licence: a Domestic Banking Licence or an Offshore Banking Licence.

### 6.3 Domestic licences

There are two categories of Domestic Banking Licence :-

*(i) Unrestricted*

A domestic banking licence permits a bank to conduct a full range of banking business with customers both in the Isle of Man and elsewhere. The licenceholder must have a real presence on the Isle of Man. This means that it must satisfy the Commission that it has on the Isle of Man its own management and staff, discrete and secure premises, and adequate systems and resources to conduct banking business.

*(ii) Restricted*

A domestic banking licence may be issued -subject to certain restrictions placed on the licenceholder.

### 6.4 Offshore licences

*Offshore Banking Licence ("Managed Bank")*

This type of licence allows a bank (the managed bank) to engage an appropriately licensed bank (an Approved Manager) in the Isle of Man - to manage the Isle of Man banking operations on behalf of the managed bank. This is achieved by way of the establishment of a branch in the Isle of Man or by way of a locally incorporated subsidiary -which is "managed" by an "Approved Manager". This is an option chosen by a bank wishing to establish an offshore presence without incurring the cost of establishing a full banking operation on the Island. Such managed banks may not conduct business with local residents, but the mechanism allows the development of the offshore presence into a full operation over a period of time. It is, in effect, an opportunity for the managed bank to 'put a toe in the water'.

From a regulatory point of view, this system also has attractions in that the Commission would have a strong existing relationship with the approved manager and will have already satisfied itself of the manager's control procedures and fit and

proper status. Clearly, the managed bank must also satisfy the Commission's initial and ongoing licensing requirements and the system does not provide a facility for a managed bank to be licensed at any sort of lower standard.

There are also two categories of Offshore Banking Licence:

*(i) Unrestricted Licence*

- permits retail banking business from off Island clients (as agreed with the Commission)

- permits interbank business - on or off island

(ii) Restricted Licence

- excludes retail business whether on or off Island

- permits intra-group banking business -as agreed by the Commission

The disclosure - to the Commission - of beneficial ownership of a licenceholder is required and once a licence is issued, changes in ownership control require the Commission's prior consent. The Commission treats a change of ownership control, though not necessarily a change in the structure of ownership, as equivalent to a new licence application. The Commission must be aware, at all times, of the identity of the owners of an institution licensed under the Banking Act.

### 6.5 Licensing and supervision

The centrepiece of the Commission's licensing policy is the "fit and proper" test. This test seeks to ensure that licenceholders have in the past done and will continue in the future to do what is correct and fair in relation to the banking business for which they are licensed or are seeking a licence.

It is impossible to define conclusively the interpretation of the term "fit and proper". However, the Commission considers that three broad criteria should be applied:

(i) integrity

(ii) solvency

(iii) competence

Essential aspects of the Commission's regulatory arrangements concern banks and financial resources and cover against risk. As regards financial resources, the Commission operates policies in relation to:

- capital adequacy and

- liquidity

For capital adequacy, the Commission requires that all institutions meet a minimum risk asset ratio of at least 10%. The requirements, however, also have regard to qualitative and business factors and many institutions have minimum ratios set well above 10%. In addition, there is a "trigger" ratio set slightly above the minimum, to provide an early threshold for consultation with the Commission and prevent a breach of the minimum. In line with Basle principles, the risk asset ratio has assumed much greater importance over the gearing ratio, as a supervisory tool. A minimum for the latter would normally be set at between 50:1 to 80:1 according to the size of capital.

Quarterly returns of maturing assets and liabilities by time band and different currency, provide the focus for supervising liquidity. Each institution is expected to have in place a statement of liquidity policy, which must be agreed as appropriate for its business with the Commission. Compliance is monitored against this policy.

There are, in addition, full requirements regarding accounts, auditing, record keeping and management information.

While the Commission seeks to ensure that the owners of banks are suitable and fit and proper and recognise their

obligations to depositors, the responsibility for the prudent and successful conduct of the bank's business rests with the directors and management. The Commission, therefore, imposes certain regulatory requirements upon the directors and management of licensed banks. These include:

- *Dual Control ("Four eyes control")*
- *Board Supervision and Control*
- *Local Directors and Company Secretary*

Supervisory information is required from banks at the end of each calendar quarter. (Offshore banks are required to report every six months). This information includes:

(i) an analysis of assets and liabilities;

(ii) an analysis of core and supplementary capital, current period's profit and loss account, provisions, large exposures, related party transactions and certain memorandum items; and

(iii) a maturity analysis, together with a geographical analysis of the non-bank deposit base and a coded listing of the banking institution's ten largest depositors.

Large exposures less than 10% of the capital base incur no special supervisory requirements. Those of 10% but less than 25% of capital have to be reported separately each quarter, with full details of the borrower, purpose of loan, security, etc. Exposures of 25% or more of capital require the prior consent of the Commission and will only be allowed if covered by a guarantee or loan take-over agreement provided by the parent.

In addition, a rolling programme of on site compliance visits is carried out by a team of Supervision Officers. Meetings may take the form of prudential visits, or blitz focus visits, the aim of which is a short but detailed examination of one small area of operation:-for example, account opening procedures.

### 6.6 Combatting abuses

The Commission has long been aware of the risk of abuse of the Island's banking facilities by criminals. As long ago as 1985, the Commission introduced a "Know Your Customer" policy, designed to alert the banks to the dangers of doing business with people they did not know and of relying solely upon introductions from the marketplace. The Know Your Customer policy requires licenceholders to seek evidence of identity, to enquire as to the nature of the business and activity of the customer and to monitor the activity of any doubtful accounts.

Since then, the Basle Supervisors Committee has introduced its Statement of Principles in December, 1988; the G7 countries formed a Financial Action Task Force on money laundering in June, 1989, which produced its Recommendations in April, 1990; and in December, 1990, the Joint Money Laundering Working Group in the United Kingdom produced its Guidance Notes for Banks and Building Societies. The Commission has produced Guidance Notes based on those issued by the Joint Money Laundering Working Group and has updated them regularly; in 1998 the Isle of Man enacted all crimes money laundering legislation which is fully compliant with the current EU Directive.

### 6.7 Legislation

The Banking Act 1998 provides substantial powers for supervisory, disciplinary and enforcement purposes. The Act enables the Commission to:

- inspect the books, accounts and transactions of a licenceholder

- search premises, seize documents using such force as necessary

- require persons to attend and answer questions

- issue public statements

- require persons to produce documents

- remove a licence

- restrict a licence

- attach conditions upon a licence

- issue directions

- declare an individual to be no longer fit or proper

- petition the Court to appoint a Receiver

- petition the Court to make a Restriction Order

- petition the Court to fine or convict in regard to a range of offences

Additionally, and unusually in the respect of an "offshore" centre, the Act provides facility to the Commission to use these powers against those who, on reasonable grounds, are suspected of conducting banking business without a licence.

All these powers are used regularly and robustly by the Commission in the execution of its functions.

In respect of offences and penalties, the Commission, is, as already explained, a prosecuting authority in its own right. The Banking Act 1998 contains criminal penalties in several significant areas.

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# 7 INVESTMENT AND SECURITIES BUSINESS

### 7.1 Investment Businesses

There are a number of different categories of licence issued by the Financial Supervision Commission under the Investment Business Acts 1991-93, although all are subject to the Commission's stringent fit and proper test licensing principles.

*Category 1*

Group A - persons who do not control clients' money or assets and who arrange deals only in a restricted range of investments (i.e. unit trusts, life and pensions products). Such persons may provide investment advice (other than to occupational pension schemes and collective investment schemes) on other types of investments, but may not arrange deals in them, except for subscriptions to new share issues.

Group B - tied agents selling the products of only one product company. Such person may control clients' money provided that the product company which the agent represents has provided an indemnity in respect of clients' monies to the Commission in an acceptable form.

All Category 1 licenceholders require minimum net tangible assets of 5000 and further details of this are available in the various Codes of Conduct.

There are 30 Category 1 licences issued.

*Category 2*

Group A - persons who arrange deals in any investment instrument but who do not receive or control clients' money; or persons who arrange deals in a restricted range of products (as in Category 1) but who may control clients' money; or persons who act as share distributor or provide share registration or accounting services to collective investment schemes established in approved jurisdictions; or persons who act as investment adviser to occupational pension schemes and/or collective investment schemes.

Group B - managers of collective investment schemes, but only where the manager is administered by a licenceholder who is authorised as Category 4 business.

Category 2 Group A licenceholders must have minimum net tangible assets of 5000 and 3 months' annual audited expenditure to be maintained as liquid capital whereas Group B requires minimum net tangible assets of 5000 and one month's annual audited expenditure to be maintained as liquid capital.

*Category 3*

Investment managers and dealers who control clients' money and assets, managers of restricted collective investment schemes (except as provided in Category 2 above), including managers of more than one 'exempt restricted scheme' within the meaning of Section 11 (7) of the FSA 1998; or persons acting as investment manager to collective investment schemes established and operated in other jurisdictions; or managers of authorised collective investment schemes; or investment businesses, other than those included in Categories 1, 2 and 4.

Category 3 licenceholders require minimum net tangible assets of 25000 and 3 months' annual audited expenditure to be maintained as liquid capital.

*Category 4*

Licenceholders providing administrative services to managers of authorised and/or restricted collective investment schemes (except as provided for in Categories 2 and 3 above).

Category 4 licenceholders require minimum net tangible assets of 100,000 and 3 months' annual audited expenditure to be maintained as liquid capital.

*Category 5*

Category 5 licences relate to those acting as stockbrokers. There are 7 licences issued to stockbrokers on the Isle of Man, 4 being the London Securities and Futures Authority members and 3 non-SFA members. Those members of the SFA are required to adhere to the Financial Resources requirements of the SFA. Those which are not are required to have minimum financial resources of 50,000 for an agency broker and 100,000 for a broadscope firm, together with a liquid capital requirement of 3 months' annual audited expenditure.

In order to be licensable, investment activity must be carried on by way of business. Thus, as in the United Kingdom, private transactions are excluded from the scope of the Investment Business Act 1991. Investment activity is licensable if it is carried on in or from the Island. Also, in practice, the Commission is unlikely to grant a licence to an organisation unless it is managed and controlled in the Island, as to do so would leave the Island vulnerable to unscrupulous operators with no accountability in the Isle of Man. This provision extends the scope of the Financial Supervision Commission's provisions further than equivalent sections of the United Kingdom Financial Services Act.

An offence is committed not only if a person conducts investment business without a licence, but also if he conducts activity with a licence but in contravention of any conditions of that licence. The conditions which are attached to investment business licences concentrate, in most circumstances, upon the scope of activity which a licenceholder is permitted to conduct.

When an investment business licence is issued, a series of Regulatory Codes apply to that licenceholder. Should a licenceholder breach any of the Regulatory Codes, the Commission is empowered to take regulatory action.

The range of activities which are included in the definition of "investment business " is wide and a variety of differing disciplines and requirements are involved. The Commission, therefore, adapts its regulatory and supervisory approach accordingly, but the basis of the Commission's licensing policy is not affected.

As with Banking licence applications already described (Section 6), the basic test applied by the Commission to any licence application is designed to seek to ensure that licenceholders (whether individuals or firms) have in the past done and will continue in the future to do, what is correct and fair in relation to the investment business for which they are licensed or are seeking a licence.

It is important to note that the fit and proper test is both an initial test at the time of granting a licence and a continuing test in relation to the conduct of the business and the relationship with the Commission.

The Commission issues Investment Business Licenses subject to conditions. A breach of a licence condition imposed is both a criminal offence and can lay a licenceholder open to action for damages at the suit of any private investor who suffers loss.

In general, as noted above, licence conditions are normally restricted to defining the scope of business which may be conducted by the licenceholder, but they may be augmented at any time by the imposition of "special" licence conditions, designed to respond to particular problems.

Because, whatever the category of licence, a person conducting business in contravention of licence conditions risks criminal prosecution and/or civil action at the suit of anyone who suffers loss, the Commission has sought to place the weight of its

regulatory ability upon the observance by licenceholders of Regulatory Codes.

These Codes, which are intended to set standards of good practice and behaviour, apply to each licenceholder. Should a licenceholder breach any of the Regulatory Codes, the Commission is empowered to take regulatory action. This action will be graded, dependent upon the seriousness of the breach.

The Regulatory Codes cover the following:

- **Financial Resources and Reporting.** These requirements are directly related to the scope of Investment Business conducted by the licenceholder. In addition, all Investment Businesses are required to maintain an adequate amount of professional indemnity insurance cover which is defined in published guidelines but is a minimum of 100,000. Licenceholders are required to submit periodical financial statements to the Commission.

- **Clients' Money.** This Code requires clients' money to be held in segregated and properly designated accounts with an approved bank on trust for investors. The Code also aims to ensure that clients' monies are properly recorded, reconciled and controlled.

- **Clients' Investments.** The principal objective of this Code is to ensure that adequate arrangements are maintained to ensure that clients' title documents are kept safely, are properly recorded, identified, segregated and controlled. A licenceholder can place clients' title documents only with eligible custodians and such title documents should be reconciled at least half yearly.

- **Conduct of Business.** This Code describes the general principles and standards of conduct which the Commission expects licenceholders to adopt in their dealings with clients and others.

- **Audit Requirements.** Auditors of Investment Businesses (other than those businesses which do not control clients' money or assets) are restricted to those firms of appropriate experience which are covered by professional indemnity insurance of not less than 10 million. The Code requires the auditor to make specific reports to the Commission in relation to the Regulatory Codes.

- **General Requirements.** This Code lays down several fundamental requirements, perhaps the most important of which is that the business of licenceholders who handle clients' money must be conducted on a day to day basis by at least two individuals (known as the "four-eyes" principle).

- **Advertising.** The Advertising Code lays down general principles relating to advertisements to which licenceholders must adhere.

The Commission's staff seek to visit each licenceholder at least once a year at a pre-arranged time when the licenceholder is required to demonstrate that the requirements of the Regulatory Codes have been met. It is likely that the Commission's staff will wish to see evidence that record keeping requirements have been complied with, that client agreements have been signed, etc. Where appropriate, the Commission also conducts unannounced focus visits, the objects of which are to call unexpectedly and examine one small area of operation - for example, Handling Clients Money - to check procedures and standards within the licenceholder.

### 7.2 Collective Investment Schemes

The Financial Supervision Commission is charged with the responsibility for administering the provisions of the Financial Supervision Act 1988 (FSA 1988) as they relate to collective investment schemes. The Act, which came into operation on the 1st November, 1988, provides for the regulation of three classes of collective investment scheme:

1. Schemes **authorised** by the Commission under Section 3 of the FSA 1988;

2. **Restricted** schemes within the meaning of Section 11 of the FSA 1988; and

3. Schemes **recognised** by the Commission under Sections 12 and 13 of the FSA 1988

*Authorised Schemes*

Currently, only authorised securities schemes (of which Government and other public securities funds are a particular type), money market funds, umbrella funds, funds of funds and feeder funds are eligible for authorisation under section 3 of the FSA 1988.

To obtain an Order under section 3 of the FSA 1988 declaring a scheme to be an authorised scheme, the proposed manager and the trustee must apply to the Commission in accordance with section 2 of the Act.

The provisions of section 3 of the Act include a requirement that both the proposed manager and trustee of the scheme must be "authorised persons", i.e. "a person holding a licence granted under section 3 of the Investment Business Act 1991 or such other classes of permitted persons (within the meaning of that Act) as may be prescribed".

So far as proposed managers are concerned, they must hold an investment business licence and only banking institutions licensed under section 6 of the Banking Act 1998 are eligible to act as trustees of authorised schemes.

An application for authorisation must be accompanied by a certificate signed by an Advocate to the effect that the contents of the scheme's constitutional documents comply with the requirements of the Financial Supervision (Authorised Collective Investment Schemes) Regulations 1988. Once a scheme has been granted authorisation, any **proposed** alteration to the scheme, or any proposal to replace either the manager or trustee, must be notified **in writing** to the Commission.

Authorised schemes must be constituted either as:

(a) unit trust schemes whose trust deed is made under and governed by the law of the Isle of Man; or

(b) open-ended investment companies to which Part 1 of the Isle of Man Companies Act 1986 applies.

Therefore, a scheme constituted under the law of another country or territory, or which is not constituted in the Isle of Man as either a unit trust or open-ended investment company, is not eligible for authorisation.

Authorised schemes are able to be promoted to the general public in the Isle of Man. In addition, because the United Kingdom Government has granted the Isle of Man "designated territory status" for the purposes of Section 87 of the United Kingdom Financial Services Act 1986, an Isle of Man authorised scheme, which is of a category specified in the Schedule to the United Kingdom Designation Order may give notice to the Securities and Investment Board ("the SIB") in the United Kingdom for recognition of the scheme pursuant to Section 87 of the United Kingdom Financial Services Act 1986. Upon receiving recognition, a scheme may, subject to certain requirements, be promoted to the general public in the United Kingdom.

Reciprocal arrangements operate between the Isle of Man, Jersey, Guernsey and Ireland in respect of authorised schemes and Isle of Man authorised schemes are also subject to "fast track" approval procedures in Hong Kong and Australia. In addition, the Japanese Securities Dealers' Association have agreed that Isle of Man authorised schemes, which have been recognised by the Securities and Investments Board in the United Kingdom, are eligible for promotion to Japanese residents.

*Restricted Schemes*

The Commission has not prescribed what types of Restricted schemes may be established as this would be contrary to its policy of providing a flexible regulatory framework in which operators can innovate and develop new products to meet the changing and developing needs of the market place. However, the Commission will have views as to the acceptability or desirability of certain types of schemes and may, in such circumstances, refuse to grant or extend a manager's licence to enable it to manage a scheme of that particular type. Generally, the Commission does not favour the establishment of restricted schemes whose primary investment objective is to invest in:

(a) assets which cannot be readily liquidated or accurately valued through a recognised investment exchange or market; or

(b) assets which are outside the normal scope of exchange traded instruments and where the Commission may have difficulty in assessing a licenceholder's ability to manage those assets.

Therefore, schemes investing in real estate, certain precious metals and gemstones, would not normally be acceptable.

Restricted schemes are not subject to any direct approval or authorisation process.

However, the manager is required to give the Commission written notice, in accordance with section 11 (2) and (3) of the FSA 1988, within fourteen days of the scheme becoming or ceasing to be a restricted scheme, and so the Commission is able to exercise some control over the establishment of restricted schemes in the Isle of Man through its licensing of restricted scheme managers.

The Commission's approach to the regulation of restricted schemes differs significantly from the regulation of authorised schemes. For restricted schemes, the Commission has sought to avoid comprehensive prescriptive regulation, leaving managers free to innovate and develop new products, whilst at the same time upholding investor protection by requiring strict disclosure of all material matters to potential investors.

Restricted schemes are subject to a general prohibition on promotion in the Isle of Man but they may be promoted to the public outside of the Isle of Man. Any advertising of a restricted scheme carried out by a licensed manager outside the Isle of Man must be in compliance with the requirements of the Advertising and Scheme Particulars Regulations and the Financial Supervision Commission (Advertising) Regulatory Code.

Certain restricted schemes are not subject to the provisions of Section 11 of the FSA 1988, or the regulations made thereunder. Section 11 (7) provides that, subject to the provisions of subsections (8) to (10), a scheme is exempted from Section 11 if:

> (a) it has less than 50 participants; and
>
> (b) the relevant constitutional document prohibits the making of an invitation in any part of the world to the public or any section of it to subscribe for or purchase units in the scheme.

In line with the intention of Tynwald when the legislation was passed, the Commission has regarded "exempt" restricted schemes as private arrangements, and therefore not subject to regulation.

The Professional Investor Fund was introduced in December, 1995, and is a special sub-category of the Isle of Man's restricted collective investment schemes classification. The launch of the PIF introduces a regulatory approach which provides a framework for the design of mutual fund vehicles which are suitable for sophisticated and high net worth individuals and market professionals. Such investors require a different level of regulation to that which applies to ordinary investors. The PIF regime provides this and brings with it flexibility and the potential for cost savings.

The Professional Investor Fund in itself is not subject to approval or regulation by the Commission. However, the operator of a PIF (whether a fund manager, third party fund administrator or bank) must obtain the Commission's prior approval before operating PIFs.

The PIF regime is based around the Financial Supervision (Professional Investor Fund)(Exemption) Order 1995 which defines the conditions for a PIF. Certain other secondary measures contribute to the regulatory approach for PIFs.

*Recognised Schemes*

The term "recognised scheme" refers to schemes which originate from outside the Isle of Man and which, subject to recognition being granted by the Commission, may be promoted to the general public in the Isle of Man.

Recognised Schemes are able to be promoted to the general public in the Isle of Man. However, anyone wishing to promote recognised schemes in the Isle of Man must either hold an investment business licence or be exempt from requiring such a licence and the scheme itself must comply with the notification requirements of the Commission and must maintain specified facilities on the Isle of Man for the service of investors.

As already mentioned, all recognised schemes must comply with the requirements of the Financial Supervision (Scheme Particulars) Regulations 1988, as they apply to authorised schemes. However, recognised schemes from designated countries or territories may be exempt from complying with some or all of the requirements of Schedule 1 to the Scheme Particulars

Regulations.

Ongoing regulation of Collective Investment Schemes takes the form of formal and informal relationships between the various parties connected to the Scheme, Manager, Custodian, Trustee and Commission.

Active compliance visits are carried out on all Fund Managers following much the same format as described under both Banking and Investment Business headings.

From time to time, the Commission has had to intervene and has powers under the Investment Business Act and the Financial Supervision Act to take a broad range of actions including public notices, searches, enquiring, directions, appointment of inspectors, winding up in the public interest, etc.

Powers of inspection and investigation mirror those already described under the Banking Act 1998 and include powers to:

- Inspect the books, accounts and transactions of licenceholders

- Search premises and seize documents using such force as necessary

- Require persons to attend and answer questions

- Issue public statements including naming institutions, or persons, and warnings to the public as appropriate

- Require persons to produce documents

- Remove a licence

- Issue directions

- Declare an individual to be no longer fit and proper

- Petition the Court to make a Restriction Order

- Petition the Court for the appointment of a receiver

- Petition the Court to fine or convict in regard to a range of offences - see above.

Similarly to the Banking Act, the IBA provides, unusually, for these powers to be used in respect of those who, on reasonable grounds, are suspected of conducting investment business without the appropriate licence.

# 8 INSURANCE AND PENSIONS BUSINESS

### 8.1 Insurance Business

*Principal Regulatory Requirements and Powers*

The principal ongoing regulatory requirements and powers of the Insurance and Pensions Authority under the Act and Regulations include the requirement:

(i) that all companies maintain a minimum solvency margin requirement at all times (the solvency margin being the amount by which the company's assets exceed its liabilities). The level of the required solvency margin will vary depending on the type and volume of business written;

(ii) to restrict, for solvency purposes, the admissibility of certain categories of assets;

(iii) to require an authorised insurer to maintain assets in a particular form or in a particular place;

(iv) to separate from those of shareholders the assets of the policyholders which are held in the Long Term Business Fund;

(v) for life assurance companies applying for authorisation, to appoint an actuary who satisfies the criteria laid down by the Insurance and Pensions Authority (ie. he is a Fellow of the Institute or Faculty of Actuaries or equivalent and has relevant experience). The appointed actuary will be responsible for certifying annually that the company's liabilities to its policyholders do not exceed its assets and that the financing of the company is adequate;

(vi) to make quarterly returns for at least three years of operation (these may then be waived if the Supervisor gives consent); and

(vii) to submit audited annual accounts and supplementary information (for life companies this includes an actuarial report and valuation by the appointed actuary). The annual returns must be certified by the directors;

(viii) to impose conditions on an existing authorisation or to revoke it;

(ix) to require an authorised insurer to supply information to it from time to time or on a particular matter;

(x) to investigate the transactions and inspect the books and records of an insurer and to seize them if necessary. This power extends to companies suspected on reasonable grounds of carrying on business without authorisation;

(xi) to petition the Court for the winding up of an insurer if it is unable to pay its debts or has failed to satisfy any obligation to which it was subject under the Act;

(xii) to petition for the winding up of a company if it has carried on insurance business without being authorised;

(xiii) in the event of a change in ownership, control or management, to be notified (The Authority has the right to object to the new principals);

These and other provisions are strictly enforced and action is taken when appropriate, including the imposition of special conditions and petitioning the Court to wind up. The Act contains special provisions in respect of the winding up of companies carrying on life assurance business. In this latter respect, most liquidations have been voluntary liquidations of solvent companies, reflecting merger and acquisition activity.

Under section 24 of the Insurance Act 1986 and section 10 of the Insurance Intermediaries (General Business) Act 1996, the Insurance and Pensions Authority may disclose formally to other agencies information which it has obtained. These agencies include the Financial Supervision Commission and other authorities which appear to the Insurance Supervisor to exercise in a country or territory outside the Isle of Man functions corresponding to those of the Insurance and Pensions Authority. Information may also be disclosed with a view to the institution of, or otherwise for the purposes of, any criminal proceedings, whether under the Insurance Act 1986 or the Insurance Intermediaries (General Business) Act 1996 or otherwise.

*Principal Matters Relating to Authorisation*

Before authorising any company to carry on insurance business in or from the Isle of Man, the Insurance and Pensions Authority must be satisfied as to:

(i) the fitness and propriety of the proposed shareholders and ultimate beneficial owners, directors and managers;

(ii) the financial resources of the proposed company. This includes consideration of a detailed three-year business plan and will include an assessment of the ability of the shareholders to commit further resources should that be necessary; and

(iii) the type and volume of business to be underwritten and the exposures to be accepted.

With regard to paragraph (i) above, extensive checks are carried out before any decision to authorise is taken. These checks will include reference to agencies on the Isle of Man and internationally.

Other matters on which the Insurance and Pensions Authority must be satisfied before authorisation is granted include:

(i) that the company has actually been incorporated;

(ii) that the beneficial interests in shareholdings have been disclosed;

(iii) that the agreed amount of capital has been paid up (the amount of capital required will vary depending on the type of business to be underwritten);

(iv) that the quality and suitability of the company's reinsurance programme;

(v) that the company will operate as a bona fide insurance company, underwriting and accepting or declining insurable risks and that it is not to be used merely as a vehicle to collect risk-free income and commissions;

(vi) that the proposed auditors have the required amount of professional indemnity insurance, this being a minimum of 10 million;

(vii) that proper books and records will be maintained on the Isle of Man at all times.

Initially, all companies have to maintain a deposit in a licensed bank in the Isle of Man and must submit a business plan to the Insurance and Pensions Authority.

All companies must be managed and controlled on the Isle of Man and maintain their books and records on the Island at all times. (This is an important aspect of the Insurance and Pensions Authority's control over the companies which it supervises - lead action has been taken within the last year in conjunction with insurance regulators in the United Kingdom, Ireland and Guernsey to enforce this provision in respect of one particular company). The Authority must be satisfied that the proposed management arrangements are adequate and appropriate for the business to be underwritten.

*Principal Matters Relating to Ongoing Supervision*

The Insurance and Pensions Authority attaches considerable importance to the value of maintaining contact with the

insurance companies which it regulates in order to remain aware of their business philosophies and objectives. It combines this with detailed examinations of information submitted to it regularly by every company, as set out below:

(i) Quarterly returns containing specified information for at least the first three years of operation (these may then be waived if the Supervisor gives consent); and

(ii) Audited annual accounts and detailed supplementary information. For life companies, this includes an actuarial report on the valuation of liabilities by the appointed actuary. The annual returns must be certified by the directors.

The quarterly returns allow the Insurance and Pensions Authority to compare actual performance against the business plan. They also allow it to see at an early stage any significant developments and problems within the business, to discuss these with the company and, if appropriate, take action.

The annual returns, signed off as "true and fair", form the basis of the detailed annual review of the business. The accounts have to be prepared in accordance with standard formats. In addition to the accounts themselves, all companies have to submit supplementary information.

On-site inspection is not routinely currently part of the supervisory regime. Where inspections are undertaken, they relate to specific enquiries.

*General Companies*

For all general companies (including captive insurance companies), this supplementary information includes analyses of the individual classes of business underwritten and the development of claims, in total and for individual years. It also includes information about the company's reinsurance programme and has to set out details of material changes being made to the company's business. From this information the company's current financial position can be assessed and also an assessment made of its likely future position. As noted above, any material changes to the business must be advised and, particularly during the early years of operation, must be incorporated in a revised business plan. This must be submitted to the Authority and may result in additional capital being required or other changes to the management structure being made.

*Life Companies*

For life companies, the supplementary information includes a more detailed analysis of the company's business than is possible in the accounts themselves. As mentioned above, the actuarial report on the valuation of liabilities prepared by the appointed actuary must also be submitted with the returns. For companies in their early years of operation, a revised three year business plan must be submitted. The business plan forms a very important part of the examination of the company's position - differences between actual and planned experience may highlight potential problems within a company (for example, differences between planned and actual expenses are analysed to identify the reasons for any discrepancy).

The actuarial report for life companies includes details of the assumptions made by the appointed actuary in making his valuation of the liabilities. It will include an analysis of any additional and contingency reserves which he considers it appropriate to include in the total amount of liabilities.

Following receipt and examination of the returns, any matters of concern are discussed with senior management of the company. For life companies, the examination includes a review of the returns by the Insurance and Pensions Authority's appointed consulting actuaries. The consulting actuaries provide technical advice to the Insurance and Pensions Authority on both specific cases and matters of general interest or concern.

### 8.2 Pensions Business

*The Principles of the Proposed Regulatory Framework*

In order to create a prudent regulatory framework for domestic and international pensions, the Isle of Man has used the United Kingdom Pensions Act 1995 as one of its prime models. However, in certain regards, the Isle of Man has, after taking extensive advice from pension professionals, other regulators and the not insubstantial input from the Authority's consulting

actuaries, deviated from the legislative requirements in the United Kingdom.

Unlike OPRA in the United Kingdom, the Isle of Man Government Insurance and Pensions Authority will require all trustees to apply for authorisation. This will involve stringent "fit and proper" requirements. The Authority believes that the quality of the trustees is paramount in the prudent management of pension schemes.

The whistleblowing requirement in the United Kingdom compels the actuary and the auditor to whistleblow to OPRA. The Isle of Man proposals compel all parties involved in pension scheme management to whistleblow. These parties will include the actuary, the administrator, the auditor, the investment manager and the trustees.

All pension schemes will be required to submit scheme accounts to the Insurance and Pensions Authority for assessment. Accounts must be submitted no later than 6 months following the end of the scheme year. In the United Kingdom, it is the scheme membership who must be provided with a copy of audited accounts no later than 7 months following the end of the scheme year.

All scheme governing documentation will require to be submitted to the Insurance and Pensions Authority for authorisation.

All schemes will require to have their scheme documentation certified by an Advocate (solicitor) to confirm that all documentation conforms to the legislation.

The Isle of Man framework will apply to personal pensions as well as occupational schemes, domestic and international.

A funding requirement, to be known as the Technical Funding Requirement ("TFR"), will be introduced. The objective will be to ensure that the funding position remains appropriate to the current and future liabilities of the scheme.

The Income Tax Division is in consultation with the Inland Revenue over the proposed changes to ensure they conform to the existing reciprocal arrangement relating to the transfer of pensions between the United Kingdom and the Isle of Man.

# 9 REGULATION OF COMPANIES AND DIRECTORS

**Types of Company**

| | 31 March 97 | 31 March 98 |
|---|---|---|
| Resident | 20,030 | 20,431 |
| Non-resident | 10,200 | 10,648 |
| Tax exempt | | |
| • general | 10,729 | 13,080 |
| • insurance companies | 183 | 183 |
| International Companies | 28 | 39 |
| Limited Liability Companies (LLC) | 30 | 95 |
| International LLC | 5 | 20 |
| **Total** | **41,205** | **44,496** |

### 9.1 Types of Company

There are a variety of different company types and structures identifiable within the Island and company formation and administration represents a significant part of the Island's financial services business. As is indicated in section 5.2 above and 17 below, there is an intention to introduce additional controls and regulation into the areas of companies and also trust business and proposals in this regard are and have been the subject of formulation and consultation.

The type and variety of corporate structure has evolved in response to commercial demands and the various forms of companies in evidence are identifiable in other competing jurisdictions. The Government's approach to company development and regulation has been to recognise the company as a valid form of business vehicle, to encourage the development of legitimate company business and to operate a registration system in relation to companies that is based on equivalent U.K. legislation. Companies engaged in specialist financial areas such as banking, insurance and investments, are, in addition, subject to regulation by either the Financial Supervision Commission or the Insurance and Pensions Authority, whichever is appropriate.

This strategy has not been sufficient to enable the Island to avoid isolated incidents where companies registered in the Island have been involved in activities which have attracted adverse public comment. It is, primarily, in an attempt to remedy this situation that the Island is proposing additional regulatory measures.

The main body of Isle of Man company law is set out in the Companies Acts 1931 to 1993, the 1931 Companies Act being the principal Act. The eight amending Companies Acts were enacted in 1960, 1961, 1968, 1974, 1982, 1986, 1992 and 1993 and are construed as one with the principal Act. The principal Act is also supported by a number of Orders, Rules and Regulations that have been made in exercise of the powers conferred by the Acts and certain other Acts of Tynwald, for example, the Fees and Duties Acts 1989.

Many of the provisions of Manx company law are derived from comparable United Kingdom provisions, and are recognisable as such.

There are 3 main classes of company registration provided for in the Island's legislation:

(a) those registered in the Isle of Man under the Companies Acts 1931-1993;

(b) those incorporated elsewhere and carrying on business within the Isle of Man under Part XI of the principal Act;

(c) those registered in the Isle of Man under the Limited Liability Companies Act 1996.

### 9.2 Responsible Agencies

The Companies Registry is responsible for registering companies; maintaining the public record of all registered companies; requiring compliance with statutory obligations, when necessary; charging statutory fees, and striking off defunct companies.

The Companies Registry is part of the Registries Division which, in turn, is the largest of the five divisions which make up the General Registry. Its responsibilities are broadly comparable to those of the Registrar of Companies in the United Kingdom. It does not form a part of the Financial Supervision Commission.

The responsibilities of the Companies Registry in relation to corporate entities are to:

(a) approve of the proposed company/ business name;

(b) verify the completeness and accuracy of registration documents;

(c) issue certificates of incorporation/ registration;

(d) oblige corporate entities to maintain their public record in the Companies Registry as required by legislation;

(e) charge and collect statutory fees and duties;

(f) remove the names of corporate entities from the register if they fail to comply with their statutory obligations. The consequence of this is that the company ceases to be able to trade legally;

(g) refer to the Attorney General's Chambers any prosecutable transgression discovered or brought to the Registry's attention;

(h) confer with the Financial Supervision Commission and other Government agencies wherever it is appropriate to fulfil its statutory obligations.

These responsibilities are carried out with 20.5 (f.t.e.) staff.

The Financial Supervision Commission has licensing, regulating and enforcement responsibilities in respect of companies conducting financial business.

The Insurance and Pensions Authority is responsible for authorising, regulating and enforcement responsibilities in respect of companies conducting Insurance and Pensions business.

### 9.3 Isle of Man Registered Companies

The liability of Isle of Man companies may be:

- limited by shares - where the liability of its members is limited to the amount, if any, that is unpaid on the shares held by them.

- limited by guarantee, with a share capital - where the liability of its members is limited to such amount as the members may respectively undertake to contribute to the company in the event of it being wound up.

- limited by guarantee, without a share capital - where the liability of its members is limited to such amount as the members may respectively undertake to contribute to the company in the event of it being wound up.

- unlimited, being a company which does not place any limit on the liability of its members.

An Isle of Man Company does not exist in law if it is not registered in the Isle of Man Companies Registry.

Companies in the Isle of Man are either registered under the Isle of Man Companies Acts and are Isle of Man companies, or they are foreign companies carrying on business on the Island and are registered under Part XI of the Companies Act. There is no corporate legal definition of residence or non-residence; these are definitions for corporate taxation purposes. Thus, an Isle of Man Company which is colloquially described as a "Non resident company" is a Manx registered company which has filed a declaration under S.2 of the Non-Resident Company Duty Act 1986. By so doing, it renders itself liable to pay Non-Resident Company Duty. Apart from the filing of the declaration under S.2 of the 1986 Act and paying Non-Resident Company Duty, such a company is no different to any other Manx registered company in the way that it may conducts its business. A non-resident company will, however, ensure that its business is controlled and managed outside of the Isle of Man so that it is non-resident for Manx income tax purposes.

At the present time, there is no requirement for an Isle of Man company to have a local agent. However, a foreign company which establishes a place of business in the Island and registers under Part XI of the Companies Act must deliver to the Registrar the names and addresses of one or more persons resident in the Island who are authorised to accept service of process of Court documents, etc., on behalf of the company.

Provided the name by which an Isle of Man Company intends to be known is not, in the opinion of the Registrar of Companies, undesirable, and the completed statutory registration documents are presented with the relevant fees, there is no power for registration to be refused.

A company is private when, by its Articles of Association, it prohibits any invitation to the public to subscribe for any of its shares or debentures, and it includes in its Memorandum of Association a provision that the company is private. Otherwise, it is a public company.

The statutory obligations on registration for public and private companies require the submission of the following documentation:

The Memorandum of Association

The Articles of Association

Form 1 - Particulars of First Directors and Secretary and Registered Office

with the correct fee.

Statutory obligations thereafter for public and private companies are to file details of certain changes, for example:

- the return in respect of each allotment of shares,

- the return in respect of a change of registered office,

- the return in respect of any change of directors or secretary,

- the return in respect of any charge created by a company,

- the annual return to be filed each year

There is no requirement to register the beneficial owner of a company.

The annual return must include details of the company's registered office, share capital, members, directors, company

secretary and indebtedness in respect of registered charges. It confirms that the company is still in existence and it enables the public and the Chief Registrar to identify any changes during the proceeding year.

The contents of the files held by the Chief Registrar in his capacity as Registrar of Companies are available for inspection by members of the public upon payment of the appropriate fee.

A company is able to borrow against its assets. If however, the borrowing is secured by a charge of the type which is set out in s.79 of the Companies Act 1931, the company must register the charge with the Registrar of Companies in order to secure the priority of the charge against other creditors or a liquidator.

A public company is required to file a copy of its financial accounts with its annual return. Private companies are not required to file a copy of their financial accounts unless they are subsidiaries of Manx Public companies, or are liable to file accounts under the Timeshare Act 1996. They are, however, required to prepare and keep audited accounts to safeguard the 'interests' of their Members.

A company may not issue any form of application for its shares unless the form is issued with a prospectus which complies with the Companies Act and is registered in the Companies Registry.

Late filing of change details results in a penalty fee being charged. Failure to file an annual return prompts a letter of enquiry which, if not responded to within 2 months, results in a sequence of statutory written and public warnings which end in the defaulting company being struck off.

In the case of insolvency, the Companies Act provides for companies to be wound up:

(a) by the Court; or

(b) voluntarily (creditors' or members'); or

(c) subject to the supervision of the Court.

The principal method of dealing with an insolvent company is for a creditor or other interested party to apply to the High Court for the making of a winding up order. There are a number of grounds on which such an application can be made to the court, the usual ground being that the company is unable to pay its debts.

The Isle of Man does not have a full time Official Receiver but the High Court does appoint official receivers on an ad hoc basis.

In a winding up by the court, a liquidator of a company is appointed by the court and has full power to gather in and deal with the assets of the company. In winding up the affairs of a company, payments to creditors must be approved by the court. When the winding up is complete, the court formally orders the dissolution of the company and discharges the liquidator.

The Bankruptcy Act 1988 provides that the High Court of the Isle of Man shall assist courts having bankruptcy jurisdiction in "any relevant country or territory" which means the United Kingdom or any part thereof and any country or territory designated as such by an order made by the Council of Ministers.

| | **Public Companies** | **Private Companies** |
|---|---|---|
| **Registration Requirements** | Name | Name |
| | Registered Office Address | Registered Office Address |
| | Memorandum and Articles of Association | Memorandum and Articles of Association |
| | Directors - Name, Home Address, Nationality & Occupation | Directors - Name, Home Address, Nationality & Occupation |
| | Secretary - Name, Home Address, Occupation | Secretary - Name, Home Address, Occupation |
| | Initial Subscribers | Initial Subscribers |
| | Capital Details | Capital Details |

| | | |
|---|---|---|
| **On-Going Requirements Requiring Notification/Approval** | Change of Name | Change of Name |
| | Change of Address | Change of Address |
| | Change in Capital | Change in Capital |
| | Change of Director/Secretary | Change of Director/Secretary |
| | Company Charges | Company Charges |
| | Prospectus for Share Issues | |
| | Annual Return and List of Shareholders | Annual Return and List of Shareholders |
| | Audited Accounts and Director's Report | Principal Activity |
| | Principal Activity | Resolutions |
| | Resolutions | |

### 9.4 Non-resident Company Duty Act 1986

A company incorporated in the Isle of Man:

- the central management and control of which actually is located outside the Island; and
- which has delivered a non-resident declaration in the prescribed form to the Registrar of Companies,

is regarded as being non-resident for income tax purposes, at least until such time as:

- the company delivers a rescission of its non-resident declaration in the prescribed form to the Registrar of Companies; or
- the Assessor concludes that the central management and control of the company has, in fact, become based in the Island.

### 9.5 Foreign Incorporated Companies

These companies, if they establish a local place of business, are required, as opposed to being permitted, to register at the Companies Registry under Part XI of the Companies Act.

On registration, such companies are required to lodge:

- certified copy of the Charter, Statutes or Memorandum and Articles of the company, or other instrument constituting or defining the constitution of the company;
- list of directors and Secretary;
- name and address of one or more persons resident in the Isle of Man and authorised to accept on behalf of the company service of process and any notices required to be served on the company.

There is no requirement to declare beneficial ownership.

Statutory obligations thereafter are to notify the Companies Registry if any alteration is made to:

- the Charter, Statutes or Memorandum and Articles of the company, or other instrument constituting or defining the constitution of the company;
- directors (and Secretary);
- the name and address of agent.

A late filing fee is payable for the filing of any document outside such time limit as is prescribed in the Acts. Also, the Registrar is able to strike defunct Part XI companies off the register if he believes they no longer have a place of business in the Isle of Man and if they fail to respond to two written warnings and one public notice.

There are statutory powers to order general investigations into the affairs of or the winding up of a company registered under Part XI.

### 9.6 Limited Liability Companies (LLCs)

The features of LLCs, constituted under the Limited Liability Companies Act 1996, are:

(a) the company has a legal personality and capacity for the exercise of its purposes and powers;

(b) the members of the company will have their liability limited to the capital which they introduce;

(c) management rests with the members although a manager can be appointed;

(d) taxation of the Company will be similar to that of a partnership in that the profits can be divided amongst the members and taxed accordingly;

(e) it will have a life limited to a period not exceeding 30 years.

This form of company is used primarily for the holding of assets and is based on a model from the United States of America.

The regulatory regimes for LLCs are:

1. The Chief Registrar may strike the company off the register if the registered office has been abandoned or the annual return is not submitted. An LLC can also be wound up under Part X (Winding Up of Unregistered Companies) of the 1931 Companies Act.

2. The Treasury or a member of the company can apply to the Court to appoint one or more competent inspectors to investigate the affairs of the company and report as the Court directs.

### 9.7 Locally Administered Companies Registered Elsewhere

All companies incorporated outside the Isle of Man that establish a place of business within the Isle of Man are required to register under Part XI of the 1931 Companies Act and a consultative exercise is well advanced about the Licensing of Corporate Service Providers (See Section 12) in which consideration is being given to the further regulation of companies generally (See Section 5.2).

### 9.8 Directors

A company incorporated in the Island is required to have at least two directors who must be individual persons. Subject to the provisions of the Companies Acts, and the Memorandum and Articles, and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company. The concept of a nominee director has no foundation in Isle of Man law.

If authorised by the company's Articles, the directors may, by power of attorney, appoint any person to be an agent of the company for the purposes of discharging the powers and duties of the company on such conditions as they may determine, including authority for the agent to delegate all or any of his powers.

If a Director grants a general power of attorney purporting to delegate his powers to a third party for an indefinite period of time, this may well be in breach of that director's fiduciary duty to the company.

Section 26 of the Companies Act 1992 provides that, where it appears to the Court that a person's conduct makes him unfit;

(a) to be a director or secretary of a company; or

(b) to be a liquidator of a company; or

(c) to be a receiver or manager of a company's property; or

(d) in any way, whether directly or indirectly, to be concerned or take part in the promotion, formation or management of a company;

the Court may make a disqualification order. The Court may treat a person as unfit, where that body corporate or person:

(a) has been convicted of an offence on the Island or elsewhere which involves dishonesty;

(b) has been convicted on the Island or elsewhere in the last 25 years of any combination of 3 or more offences under the Isle of Man Companies Acts 1931-1993 or legislation having equivalent effect in any country or territory outside the Island;

(c) has been convicted of any offence under the Prevention of Fraud (Investment) Act 1968, the Banking Acts 1975-1998, the Insurance Act 1986, the Companies Securities (Insider Dealing) Act 1987, the Financial Supervision Act 1988, the Investment Business Acts 1991-1993 or legislation having equivalent effect in any country or territory outside the Island; or

(d) has failed to comply with an Order of the Court to rectify a default in relation to any provision of the Companies Acts.

These provisions are expressly stated to be "without prejudice to the generality" of the general test of unfitness.

There are a number of other "disqualification" provisions contained within the Companies Acts:

(a) Section 208, Companies Act 1931 which provides that where an Order has been made for the winding up of a company by the Court and the Official Receiver has made a report stating that, in his opinion, fraud has been committed by a person in the promotion or formation of the company or by any director or officer of the company in relation to the company since its formation, the Court may order that the person, director or officer concerned shall not, without the leave of the Court, be a director of, or in any way directly or indirectly be concerned in or take part in the management of a company for such period not exceeding 5 years as may be specified in the order;

(b) Section 259 (4), Companies Act 1931, which provides that where a person has been declared to be personally responsible for the debts or liabilities of the company on the grounds of "fraudulent trading" or has been convicted of "fraudulent trading", the Court may make a disqualification order for a period not exceeding five years.

Although there have been no instances of disqualification relating to these powers, the Financial Supervision Commission have used similar powers which enable them to declare persons unfit and improper on a number of occasions. These provisions are included within the Investment Business Acts 1991-1993.

# 10 PARTNERSHIPS

### 10.1 Policy

The partnership is, on the Island, as elsewhere, an acceptable form of business organisation. Legislation has been in place governing partnerships since 1909. As a form of organisation, it continues to be favoured by the professions, particularly lawyers and accountants.

For Manx tax purposes, partnerships are not assessed to income tax. It is the partners of the partnership who are assessed. The taxation treatment is, therefore, dependent upon where the business of the partnership is carried on and where the partners are resident for tax purposes.

Apart from the traditional unlimited partnership, the limited partnership has become a recognised form of organisation in Manx law.

### 10.2 Limited Partnerships

Limited partnerships are used for a number of purposes, for example, as investment vehicles for ship financing purposes. They are similar to the German KG (Kommanditgesellschaft) in that they have a general partner and a number of limited partners who are investors.

In a limited partnership, there are one or more general partners who are jointly and severally liable for the debts and liabilities of the partnership, and one or more limited partners who are liable for the debts and liabilities of the partnership up to the limit of their respective contributions to capital. A general partner may be a corporate entity. Limited partners contribute capital to the business, but are excluded from management of the partnership business. There are 51 limited partnerships registered, primarily involved with shipping and related services and investment holding business.

Limited partnerships are attractive because:

1. As a legal entity they are recognised and used throughout Europe and the rest of the world;

2. The limited partners' liability for the debts of the firm can be limited to their contribution of capital to the partnership.

Every limited partnership is required to maintain a place of business in the Isle of Man and have one or more persons resident in the Isle of Man authorised to accept service of any process or documents served on the partnership.

Registration of a limited partnership occurs when the partners send a statement to the Registrar detailing the firm name (the name in which the business is carried on), the general nature of the business, the principal place of business, the full name of each partner, the term, if any, for which the partnership is entered into, and the date of commencement, a statement that the partnership is limited and a description of every limited partner. The partners can also enter into agreements that govern the relationship between them, for example, the proportions in which profits and losses are shared.

The Registrar must be informed of any change in the principal place of business, character of the business, name and address of person appointed to accept service for the partnership, the liability of any partner if it becomes limited rather than general.

All limited partnership files are available for public examination in the Companies Registry and copies can be obtained of the contents on payment of the appropriate fee.

# 11 REGULATION OF TRUSTS AND TRUSTEES

### 11.1 Trusts

Trusts have been recognised in the statute law of the Isle of Man for many years and the trust concept is now well established in the Isle of Man. The principles of trust law and equity as developed in England apply in the Island insofar as they are not contrary to any local rule or custom.

The general body of trust law in the Isle of Man is based on legislation and case law. That law has created a system which imposes duties on trustees of trusts governed by Manx law which, in general, is no less onerous than those imposed by the general system of trust law in England.

The various types and categories of trusts which are established under English law are also found in Manx law. Trusts are utilised for many and various purposes and play a useful role in commercial and private client situations in precisely the same way as they are used in the United Kingdom and elsewhere.

The advantages which trusts established in the Isle of Man may offer depend to a large extent on the legislation of other countries. In those cases in which the settlor and the beneficiaries are resident outside of the Isle of Man, the Assessor of Income Tax in the Isle of Man looks through the trust and no assessment to Manx income tax is raised in respect of it. It is often the case that professional advisers will submit a copy of the trust instrument to the Assessor together with confirmation that the settlor and the beneficiaries reside outside of the Isle of Man with a view to obtaining confirmation from the Assessor that no assessment to Isle of Man tax will be raised. Other than this, there is no obligation to declare the identity of the settlor and/or the beneficiaries of a trust to any person in the Isle of Man.

The principal legislation in the Isle of Man relating to trusts is set out in the Annex.

Most of the legislation is based on English law, save that under the Purpose Trusts Act 1996, trusts may be established to fulfil a particular non-charitable purpose rather than for the benefit of a particular beneficiary, which would not be possible in English law.

It should be noted that the Island's Fraudulent Assignments Act 1736 is analogous to the old Statute of Elizabeth in England and makes voidable any trusts set up with a view to defeating creditors whether or not such creditors were ascertained at the date of the creation of the trust. It is generally accepted, therefore, that so called "asset protection trusts" would be liable to be set aside under Manx law.

### 11.2 Trust Regulation

There is no formal requirement to register trusts although, as noted above, there is a well developed practice whereby trusts may be inspected by the Assessor of Tax, at the option of professional advisers.

There is, at present, no formal regulatory regime as such which applies to trusts, although it is the intention that persons who provide the services of professional trustees will be brought into the corporate service provider legislative regime in due course; all persons acting as professional trustees will have to show that they are fit and proper to act. The absence of a formal regulatory system for trustees and trusts in the Isle of Man means that, as in the United Kingdom, there are no reliable data about trusts managed on or from the Isle of Man.

It is important to note that, if trusts are utilised in relation to investment and/or pension schemes, then those trusts and the trustees thereof will be subject to regulation by the Financial Supervision Commission and/or the Insurance and Pensions

Authority.

The Courts in the Isle of Man are able to enforce against trustees all the remedies which are available to plaintiffs in Chancery proceedings in the English Courts and in some important respects, such as in developing the duties of a protector (Steele v Paz Limited), the use of Norwich Pharmacal Orders to ascertain beneficial ownership of trust assets, and exploring the feasibility of remedial constructive trusts (Cotter v Cusack), the jurisdiction relating to trusts continues to develop in the Isle of Man and takes account of decisions in England and other jurisdictions.

Trusts established for charitable purposes may be enforced at the suit of the Attorney General on behalf of the public of the Isle of Man.

The Island's law in relation to trusts and the regulation of trust service providers is to be the subject of review.

# 12 REGULATION OF CORPORATE, TRUST AND INVESTMENT SERVICE PROVIDERS

### 12.1 Corporate Service Providers

The Council of Ministers has asked the Financial Supervision Commission to devise a regulatory system for those who form and administer companies by way of business in, on or from the Isle of Man. Such businesses will be known as Corporate Service Providers (CSPs). A consultative document containing the Commission's proposals was issued in October, 1997, and final amendments to the proposed legislation are now being made.

The main provisions of the proposed system are:

that all persons (including bodies corporate) on the Isle of Man who:

- form or sell companies by way of business;

- provide a registered office or accommodation address for companies (whether Manx or otherwise) by way of business;

- provide directors (either themselves or through an associate) for companies by way of business;

will be required to be licensed. These persons will be known as Corporate Service Providers (CSP). It is intended that the list of licensable activities should be able to be amended by order.

CSPs will be required to be licensed by an appropriate Regulatory Body ("the Regulator"). The Regulator will license an applicant only if he can be satisfied that it is a fit and proper person (embodying the concepts of integrity, solvency and competence).

The Regulator may revoke the licence of a CSP if he believes that the CSP is no longer fit and proper.

The proposed legislation would also prohibit the incorporation of a Manx company by someone who is not resident in the Isle of Man. Furthermore, non-resident companies, exempt companies and international business companies will only be able to be incorporated by a CSP.

The main responsibilities of the CSP would include to "Know his Customer" and, where directors are provided, to take reasonable steps to ensure that those directors are suitable for their role, that they understand their duties, responsibilities and liabilities as directors.

A licensed CSP will be required to:

- adhere to a Code of Conduct;

- maintain sufficient working capital to enable it to meet its liabilities as they fall due;

- submit an annual return to the Regulator confirming compliance with the Regulator's requirements;

- submit ad hoc notifications to the Regulator, for example, when there are changes in management, ownership, etc., of the CSP or when any legal action is taken against the CSP.

The enforcement powers and rights of intervention envisaged are:

- Power to impose conditions/issue formal directions

- Power to issue public statements

- Power to require information

- Power to carry out investigations

- Suspension or withdrawal of licence

- Powers of restitution

- Fines

- Power to apply to the Court for injunctions.

Any information obtained by the Regulator when exercising his functions under the new legislation would be subject to legitimate confidentiality provisions.

It is intended to keep this legislation, as far as possible, a matter for civil law. It is, therefore, proposed that only the following should constitute a criminal offence:

- Acting as a CSP without being properly licensed;

- Knowingly or recklessly making false or misleading statements or providing false or misleading information to the Regulator; and

- Obstructing the Regulator during its carrying out of a statutory investigation.

The Regulation of Corporate Service Providers Bill is programmed to be introduced into the legislature during the next legislative session of Tynwald and, subject to Tynwald approval, is likely to become law in 1999. It is recognised that there will be significant resource implications required consequent upon the implementation of this legislation.

### 12.2 Lawyers

The Isle of Man Law Society was formed by the Law Society Act 1859 passed by Tynwald under which the Society was incorporated as a body corporate with perpetual succession. At the time, there were 29 practising Advocates in the Isle of Man.

In 1966, there were only 25 practising Advocates in the Isle of Man, which number reflected the then depressed state of the Isle of Man economy. By 1985, the number of practising Advocates had only increased to 33. In 1998, there are 89 practising Advocates and the Manx Bar has the necessary expertise to meet the requirements of the international finance community.

In 1986, Tynwald enacted the Legal Practitioners Registration Act 1986. This Act enabled legally qualified persons from outside the Isle of Man to come to the Isle of Man to work and provide legal services in most matters. There are 77 legal practitioners, other than Manx advocates, registered on the Island, most of whom are British barristers or solicitors.

Also in 1986, Tynwald passed legislation to introduce the Advocates Disciplinary Tribunal. This Tribunal consists of a legally qualified chairman appointed by the Governor, two persons nominated by the Board of Consumer Affairs (one of Government's Statutory Boards) and two persons nominated by the Council of the Law Society. All formal complaints against Advocates have, since 1986, been dealt with by the Advocates Disciplinary Tribunal. Prior to 1986, complaints were dealt with by the Law Society.

Advocates firms on the Isle of Man range from sole practitioners who primarily provide general advice, to larger practices with specialist departments providing advice and assistance in areas such as banking, insurance, aviation, shipping, trust,

litigation and generally those legal services required of it by the finance sector. Many Advocates firms also employ specialist solicitors qualified in other jurisdictions.

Members of the Society who undertake Investment Business are required to apply to the Council of the Law Society for authority to do so as they are regulated by the Society in their conduct of such business. Practice Rules have been issued to the members in conjunction with the Financial Supervision Commission.

### 12.3 Accountants

The 1996 Census indicated that there were 444 qualified accountants on the Island.

All the major accountancy bodies are represented on the Island. The majority of accountants in the Isle of Man are members of the Institute of Chartered Accountants in England and Wales, the Association of Chartered Certified Accountants and the Chartered Institute of Management Accountants.

All Chartered Accountants on the Island are members of one of the three "British Isles" Chartered Accounting Bodies, ie. the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants in Scotland and the Institute of Chartered Accountants in Ireland. Each of these bodies has established Bye-Laws and Regulations with which their members are required to comply; in particular, the Bye-Laws include detailed requirements in relation to professional conduct and provide for a formal investigation and disciplinary process. Accordingly, members in the Isle of Man are regulated in precisely the same manner as members elsewhere in the British Isles.

There are 47 CIMA members on the Island with members located in the sectors of finance, tourism, transport, retailing and consultancy.

There are presently 108 ACCA members on the Island, 60 of whom are employed in industry and commerce, 27 are in public practice (of whom 12 hold ACCA practising certificates); 2 are employed in the public sector and 19 others have no business details. The 12 who hold ACCA issued practising certificates are monitored by ACCA's Practice Regulation Department in order to ensure that regulatory requirements are being met.

In addition, there are a small number of accountants who are members of the Chartered Institute of Public Finance and Accountancy.

With regard to professional conduct, all chartered accountants are bound by the mandatory requirements of their respective Institutes in relation to ethics and independence issues. These requirements address the very limited circumstances when an audit firm may undertake the provision of services to companies where the shareholders are trust entities in respect of which the firm provides trust/fiduciary services. Generally, chartered accountancy practices carrying on both audit and trust work are structured in one of two ways. Either all of the services provided are carried on through the chartered accountancy partnership or, alternatively, in the case of a number of firms, a separate trust company has been formed, the Directors of which would be the partners in the practice.

# 13 CRIME PREVENTION POLICIES AND STRUCTURES

### 13.1 Policy and International Agreements

The Island has a very clear commitment to prevent, deter and punish crime of all kinds, including tax offences, within the Island and is willing to assist other jurisdictions in the pursuit of criminals and crime to the greatest extent possible.

To that end, the Island has introduced an armoury of laws, regulations and enforcement practices similar to those of the United Kingdom, together with modern systems designed to maximise the chances of detection, prosecution and confiscation. The authorities collaborate with authorities in the United Kingdom and other jurisdictions regularly in pursuit of serious crime.

### 13.2 Prevention of Money Laundering

From the earliest days, Isle of Man Government has been committed to ensuring the Island offers no welcome to money launderers. The Anti-Money Laundering Guidance Notes, first issued in 1991, and 1992 for Investment Business and in 1996 for Insurance Business, were significant early steps in setting out the minimum standards expected of licenceholders.

In recent years, the Financial Action Task Force against money laundering formed by the main industrial nations (FATF) has increased international pressure to urge compliance within their 40 recommendations and the Isle of Man has a firm policy to support and comply with the 40 recommendations. The Treasury Minister has given a formal undertaking of support to the FATF on behalf of the Isle of Man Government.

In May, 1987, Tynwald passed the Drug Trafficking Offences Act. That Act was almost entirely based on the Drug Trafficking Offences Act 1986 (an Act of the Westminster Parliament) and the Criminal Justice Act 1991 extended the scope of the money laundering provisions of the 1987 Act.

The Prevention of Terrorism Act 1990 created offences of assisting in the retention or control of terrorist funds, whether by concealment, removal from the jurisdiction, transfer to nominees or otherwise.

The Drug Trafficking Act 1996 consolidated, with amendments, the Drug Trafficking Offences Act 1987. The Act was closely based on the Drug Trafficking Act 1994 (of the Westminster Parliament). It retained all the "laundering" offences and added new offences of failing to disclose knowledge or suspicion of the laundering of the proceeds of drug trafficking and of prejudicing drug money laundering investigations by "tipping-off". The same extensive powers for the Police and Customs Authorities to obtain information were repeated.

In July, 1993, the Westminster parliament passed new legislation to create offences in relation to the laundering of the proceeds of crimes other than drug trafficking. These new offences were very closely modelled on the money laundering offences contained in drug trafficking legislation. A Criminal Justice (Money Laundering Offences) Bill was introduced into the House of Keys in 1997. It has been enacted and came into effect on the 1st July, 1998. The new Act mirrors the money laundering offences contained in the United Kingdom Criminal Justice Act 1993 and the Island's anti-money laundering legislation is fully compatible with the FATF 40 recommendations.

A Police Powers and Procedures Act also passed into law this year. That Act gives the Police additional powers of entry, search and seizure in relation to serious arrestable offences. These are powers which will be available to assist in obtaining evidence and intelligence for criminal investigations and proceedings in both the Isle of Man and outside the Isle of Man.

The statutory powers follow very closely provisions contained in the Police and Criminal Evidence Act 1984 (an Act of the Westminster parliament).

*FATF-style Evaluation*

In 1994, the Isle of Man's legislation and procedures for combatting money laundering were subjected, at the Island's own invitation, to a FATF-style evaluation by United Kingdom and Dutch officials of the FATF. The conclusions from this review were that:

> "49. The Isle of Man is in substantial compliance with the FATF Recommendations. Its legislation is effective, and following the passage of the new Criminal Justice Bill, it will be more so. Financial supervisors and financial institutions are aware of the threat posed by money laundering, and have taken action against it from a very early stage.
>
> 50. The limited experience that individual financial institutions have had of money laundering cases may limit the effectiveness of the legislation, but the new guidance notes will help address this. Closer discussions between the Financial Supervision Commission, the Fraud Squad and the financial institutions on individual cases would also improve the understanding of the problems posed by money laundering at the level of individual financial institutions."

[Note: The Criminal Justice Bill referred to in the conclusions was an earlier and less comprehensive version of the legislation subsequently enacted in 1998.] A fresh evaluation under the auspices of the FATF in co-operation with the Offshore Group of Banking Supervisors is planned for late in 1998.

The Criminal Justice (Money Laundering Offences) Act 1998 is concerned primarily with the reporting of transactions and the confiscation of assets. It has created a number of new substantive offences in relation to the laundering of the proceeds of crime other than drug trafficking. As part of the scheme of the Act, defences are created in certain cases if a transaction is reported to the Police. The information contained in such a report, because of section 17G in Schedule 2 to that Act, is subject to a duty of confidence. The duty does not apply to information in the hands of the Police from any other source nor to suspicious transaction reports concerning drug trafficking. The restrictions in the proposed section 17G are based on provisions in the Financial Services Act 1986 (an Act of the Westminster parliament).

The Police will be able to disclose the information to which the restrictions apply to persons in the Island for criminal investigations purposes and on other grounds. Disclosure to persons outside the Island are permitted under section 17I with the consent of the Attorney General if the information is disclosed for the prevention or detection of crime or the institution of or otherwise for the purpose of criminal proceedings outside the Island. The Attorney General proposes to issue general consents which will permit the Police to pass the information to NCIS, etc., without individual specific consents from the Attorney General. This course of action is specifically permitted by Section 17I. The Island authorities are currently considering the provisions of a draft memorandum of understanding with NCIS on mutual co-operation.

It is emphasised that the requirement for the Attorney General's consent only applies in respect of information contained in a suspicious transaction report made for the purposes of the Criminal Justice (Money Laundering Offences) Act 1998. It does not apply to any other information in the hands of the Police.

One of the key tools in the fight against money laundering is education. The need to raise awareness of the problem and the legal requirements placed upon businesses and individuals is a high priority. Seminars and conferences on money laundering have been held on the Island over a period of several years at the instigation of various Island authorities. These have been targeted at accountants, banks, insurance companies and stockbrokers. Representatives of all the local law enforcement and regulatory bodies have given presentations and answered questions and given information on trends. Assistance has also been given to the Law Society, with Customs, Police officers and the Chief Executive of the Financial Supervision Commission giving presentations to a recent training seminar. These seminars will be repeated on a regular basis to keep the importance of the issue in the forefront of the minds of the industry and to cater for regular changes in personnel.

It is in the nature of things that data are not available on the quantities of money laundered in any jurisdiction. What can be said, however, is that the possibility of laundering money unnoticed "through" a bank in the Isle of Man where the banking industry is small and well regulated is much reduced compared to other larger jurisdictions.

### 13.3 Tax Offences

*Indirect Taxation*

The Customs and Excise Agreement with the United Kingdom provides both parties with benefits and enables a common customs and fiscal area to exist. There is full co-operation between the two Customs organisations to prevent abuse of the indirect tax and duty systems. Through the Agreement, the Island has access to the European Single Market and has increasingly developed investigation, intelligence and data links with the EU and its members.

The Investigation and Intelligence Unit deals with many tasks undertaken elsewhere by fraud investigation units, including investigation of drug money laundering, VAT fraud, excise fraud, customs fraud, obtaining evidence, restraining and confiscating assets, assistance to other jurisdictions and sanctions.

Financial investigators from the Fraud Squad and Customs and Excise meet weekly. There is liaison of a less formal nature with other areas of the Isle of Man Constabulary. These links are being reviewed with a view to improving them by the signing of a memorandum of understanding.

*Direct Taxation*

The Income Tax Acts provide for both civil and criminal offences. The pursuit of non-compliance, whilst the specific responsibility of a number of officers in the Income Tax Division who have been trained accordingly, also forms part of the duties of various other groups within the Division.

Whilst offences will normally be investigated by officers of the Division under the provisions of the Income Tax Acts, in serious fraud cases investigations will be undertaken jointly with the Fraud Squad. The Legal Officer (Fraud) in the Attorney General's Chambers provides legal advice in such cases and determines the legislation under which proceedings are to be brought.

The Island has a Double Taxation Agreement with the United Kingdom. Section 15.4 of this report deals with this subject.

### 13.4 Police

The Isle of Man Constabulary comprises 218 Police officers and 37 Civilian support staff. Historically, the Chief Constable has been appointed from outside of the force and approximately one third of the force has experience in other jurisdictions.

The Fraud Squad has a staff of 8 Police officers, 1 accountant and a Civilian office manager. It also has a dedicated advocate in the form of the legal officer (fraud) on the staff of the Attorney General's Chambers.

As well as the work of financial investigation, the Fraud Squad also investigates alleged financial crime. The Fraud Squad also maintains its own intelligence data base. It also handles all requests for assistance from other jurisdictions, whether or not they relate to fraud or financial matters.

The Police Force is regularly inspected by one of Her Majesty's Inspectors of Constabulary to ensure that it is an effective force meeting standards equal to those in the United Kingdom.

**POLICE, CUSTOMS, FRAUD AND FINANCIAL INVESTIGATION UNITS**

***Police***

| | |
|---|---|
| **Chief Constable:** | Mr. R.E.N. Oake |
| Staff: | 218 (Constabulary)<br>37 (Civilian support) |

***Fraud Squad***

| | |
|---|---|
| **Head:** | Inspector C. Daughen |
| Staff: | 8 Police (Plus Accountant, Legal Officer and Office Manager) |

***Customs and Excise***

| | |
|---|---|
| **Head:** | Mr. D.G. Maxwell |
| Staff: | 44 |

# 14 INTELLIGENCE

### 14.1 Access to Financial Information about Individuals and Companies

The Isle of Man has no banking secrecy or other confidentiality laws. There is, however, as in the United Kingdom, the common law duty of care in respect of confidentiality and a respect for privacy. There are also restrictions on the passage of information contained in section 24 of the Insurance Act 1986 and sections 22 to 24 of the Financial Supervision Act 1988, the Data Protection Act 1986 and sections 106 to 106B of the Income Tax Act 1970.

Notwithstanding these limitations, the various regulatory and enforcement agencies have powers equivalent to their counterparts in the United Kingdom to obtain financial information on individuals and companies.

Specifically, the Island has enacted legislation which erodes the common law rules of confidentiality, especially in cases where crime or money laundering are suspected, except with regard to legal professional privilege. These specific powers are described in Section 15.1.

### 14.2 Underground Banking and Shell Banks

The Isle of Man has not so far experienced any significant problems of underground banking. There have, however, been a few occurrences of 'shell banking', e.g. banking being conducted without a licence, and these have been investigated and stopped by the Enforcement Division of the Financial Supervision Commission at the very earliest opportunity. As is described elsewhere, the Commission has a strong enforcement policy and immediately uses its powers to injunct the company's activity and petition the court to freeze assets. Additionally, the Commission has powers to wind up in the public interest and does not hesitate to put matters for consideration before the court.

### 14.3 Transaction Reporting by Banks and Others

The Island authorities collaborate closely with banks and others with a view to identifying crime of all kinds, including fraud, tax evasion and money laundering. Ongoing liaison is maintained as part of the regular consultation between the Island's regulators and industry representatives.

As in the United Kingdom, the Island has a system for suspicious transaction reporting by banks, other financial institutions, lawyers, accountants and companies and other professional practices and partnerships. The obligation to report such transactions is set out in the various legislation relating to the prevention of terrorism, drug trafficking and money laundering.

Institutions are obliged to have Money Laundering Reporting Officers and, where necessary, Prevention Officers.

Both the institutions concerned and individual staff have a duty of vigilance. If they do not comply, they are liable to substantial penalties. Knowingly assisting another to retain or conceal the proceeds of crime, or to transfer those proceeds to another jurisdiction, nominee, or otherwise, carries a maximum penalty on conviction of 14 years imprisonment.

The reports are submitted to, and processed by the Fraud Squad and a steady increase in the number of reports year by year indicates the increased awareness within the Island of the possibilities of international financial crime and the need to safeguard the Island against being used to rechannel the proceeds of that crime.

The whole area of financial disclosure is an important one, causing financial institutions (and in reality all businesses) the

onerous task of deciding whether to report details of hitherto confidential financial transactions to the police. Legislation requiring such disclosure has meant that businesses have had to modify their philosophy in the area of client confidentiality, adopting a more questioning approach.

The system works well and Isle of Man businesses have shown a good understanding of the law and that they are committed to the fight against money laundering.

### 14.4 Unexplained Lifestyle

Unexplained lifestyle may be a factor to be taken into account as part of an intelligence gathering operation but cannot be the sole determinant of enforcement action. There is no regular and systematic scrutiny of the population to identify cases where lifestyle does not match apparent resources, but the authorities are able to take lifestyle into account as part of investigatory or intelligence gathering operations.

Provisions similar to those in the United Kingdom Proceeds of Crime Act are contained within a Criminal Justice Bill included within the Island's legislative programme.

### 14.5 Sharing of Intelligence

The sharing of information is dealt with fully in Section 15. Much of the comment applied to sharing information applies to the sharing of intelligence. The Island authorities are generally willing to share the intelligence they have with other jurisdictions in pursuit of serious crime.

Some financial disclosures are made to Customs officers. These disclosures are referred to the Fraud Squad as the central collation point, but they and any other disclosures made directly to the Fraud Squad may be investigated by Customs and Excise.

Officers of the Constabulary provide intelligence to both the D.H.S.S. and income tax officers concerning individuals who apparently live beyond their means.

The Constabulary is willing to share information and intelligence with regulatory bodies and law enforcement agencies world-wide (See table below). Locally, weekly meetings are held with Customs officers whilst information of mutual benefit is exchanged with regulators as and when necessary, which means frequently.

**Statistics**
**(Intelligence Sharing with Other Jurisdictions)**

| | *1996* | *1997* | *1998 (to end June)* |
|---|---|---|---|
| Interpol requests | 74 | 80 | 61 |
| U.K. force requests | 209 | 227 | 120 |
| Foreign force requests | 73 | 51 | 40 |
| Crown dependencies | 17 | 10 | 12 |
| Visiting officers | 66 | 85 | 67 |

# 15 INVESTIGATION

### 15.1 Obtaining Information

A number of agencies of the Isle of Man Government have statutory powers to require or obtain information which may be of relevance to financial crimes. These powers are broadly comparable to those available to equivalent agencies in the United Kingdom.

*(a) Attorney General*

The Attorney General has powers under sections 24 and 25 of the Criminal Justice Act 1990 (an Act of Tynwald) to require information to be furnished and documents to be produced for the purposes of investigation into serious or complex fraud. When necessary, a search warrant can be granted by a Justice of the Peace in support of a requirement. The powers are used by the Attorney General, or can be delegated by him, to Police Officers, for the investigation of serious and complex fraud committed within the jurisdiction of the Isle of Man. The powers are based on those conferred on the Director of the Serious Fraud Office in London.

*(b) The Police*

In a significant number of cases, the Police are able to apply to a Justice of the Peace for a warrant for access to documents or information to assist in the investigation of crime. The provisions which are relevant for this purpose are:-

- Section 2 of the Prevention of Fraud (Investment) Act 1968 under which a constable may enter and obtain access to documents and information relating to breaches of restrictions on the distribution of investment circulars.
- Section 108 of the Copyright Act 1991 gives a constable access to evidence relating to offences concerning intellectual property rights.
- The Customs and Excise Management Act 1986 confers on constables similar powers of search etc to those exerciseable by officers of Customs and Excise under that Act.
- Section 28 of the Theft Act 1981 gives Police Officers powers to search for evidence or stolen goods.
- Section 13 of the Computer Security Act 1992 gives constables access to information relating to breaches of that Act.
- Schedule 2B of the Misuse of Drugs Act 1976 contains powers to enable constables and officers of Customs and Excise to stop, search and obtain information on ships suspected of being used for illicit traffic in narcotic drugs.
- Schedule 7 to the Prevention of Terrorism Act 1990 confers on the Police powers of access to information. Warrants issued in the UK to the British Intelligence Services are recognised and validated for purposes of Manx law.
- Part 4 of the Drug Trafficking Act 1996 confers powers on constables to obtain information about alleged drug trafficking offences and the proceeds of drug trafficking.
- The Police Powers and Procedures Act 1998 confers general statutory powers of entry, search and seizure in the case of serious offences. Those powers may also be used for the collection of evidence in respect of crimes

committed outside the Island.

- Section 22 of The Drug Trafficking Offences Act 1987 makes similar provision for Production Orders as the Drug Trafficking Act 1996 and the use of either Act is determined by the date of the offences being investigated.

(c) Customs and Excise

- Officers of Customs and Excise have powers of access to information conferred by the Customs and Excise Management Act 1986. The powers are exerciseable in relation to excise matters, imports and exports and are the same as those exerciseable in the United Kingdom by HM Customs and Excise.

- The Value Added Tax Act 1996 contains powers for Customs and Excise officers to gain access to information for the purpose of value added tax offences.

- The Police Powers and Procedures Act 1998 supplements the powers of officers of Customs and Excise (such as in obtaining search warrants for evidence of customs and excise offences) in the same manner as the Police and Criminal Evidence Act 1984 did in the United Kingdom.

- Customs and Excise have powers under the Drug Trafficking Act 1996 to obtain Access Orders etc. in relation to the proceeds of drug trafficking, and to have any such proceeds confiscated following conviction of a drug trafficking offence in either the Island, United Kingdom or any of a number of other specified countries. The power to seize money at ports is also available to the Police as well as to Customs Officers.

- There are also powers to seize and detain large amounts of cash carried by travellers entering or leaving the Island if the money is suspected as being connected with drug trafficking. The limit is set at 10,000 for administrative purposes in the Isle of Man to coincide with the level legally defined by Her Majesty's Customs and Excise.

*(d) Financial Supervision Commission* The Financial Supervision Commission has comprehensive powers to obtain or require information from all categories of business which are licensable by the Commission, i.e.

- Banks and Deposit Taking Institutions

- Investment Businesses

- Collective Investment Schemes

- Fund Managers

- Building Societies.

The Commission may also obtain information from those suspected, on reasonable grounds, to be engaged in such business without licence. Additionally, it has power to obtain information from any third party, where it is believed that party has information relevant to any investigation - See 6.1 and 6.2.

*(e) Insurance and Pensions Authority*

The Insurance and Pensions Authority has extensive powers under the Insurance Act 1986 and the Insurance Intermediaries (General Business) Act 1996 to require information for the purpose of exercising its functions. The specific powers are contained in sections 21 and 22 of the Insurance Act 1986 and sections 7 and 8 of the Insurance Intermediaries (General Business) Act 1996.

The Insurance and Pensions Authority may also require the insurer's actuary, auditor, insurance manager or banker to provide the information if the insurer itself fails to provide it.

These powers may be exercised by the Insurance Supervisor or by any person appointed in writing by the Insurance and Pensions Authority

*(f) Assessor of Income Tax*

Except for the purpose of Manx tax the Assessor does not undertake criminal investigations. In cases where serious tax offences are suspected, investigation will be undertaken jointly by the Police and the Assessor's office. The Legal Officer (Fraud) in the Attorney General's Chambers provides legal advice in such cases.

In relation to direct taxation the Assessor of Income Tax has authority under the Income Tax Acts to require information from various sources, the most important of which are all persons, corporate or individual, liable to income tax on the Island, exempt or international companies and persons making taxable payments.

There is also the ability under provisions contained in Social Security legislation to obtain information from that Department.

The Income Tax authorities in the Island have only limited powers to enforce the production of information and do not have any general power to make searches. The only search provision is a specific one within the Income Tax (Instalment Payments) Act 1974 enabling access to be gained if there is reason to believe that evidence will be found on the premises to show that the terms of the Act have not been complied with. Where the premises relate to a private dwelling house a warrant has to be obtained from a Justice of the Peace.

*(g) General*

In the case of all offences, the Isle of Man authorities are able and willing to require the production of documents and information wherever the actual or suspected crimes were committed. There are powers of entry, search and seizure which support those powers. The new Police Powers and Procedures Act has given extra powers to the Police additional to those which have been exercisable by the Attorney General and the Police in respect of crimes in the past.

There are no cut-offs in fraud cases. The statutory powers apply to criminal offences in respect of fiscal matters in the same manner and to the same extent as the English legislation on which they are based.

The legislation requiring disclosure clearly sets out the requirements and penalties for breaches of the law. To date, there have been no prosecutions on the Island for such offences. More than half of the 1997 disclosures came from banks, with almost all of the rest emanating from Insurance Companies.

Applications may be made to the Courts for orders in respect of bankers' books under the Bankers' Books Evidence Act 1935. The Act is based on the Bankers' Books Evidence 1879 (an Act of the Westminster parliament).

### 15.2 Sharing Information Inside the Jurisdiction

There are some restrictions on the sharing of information between agencies of the Government (See Section 14.1). These restrictions notwithstanding, there are a number of instances where information can be shared.

Section 106 (A) of the Income Tax Act 1970 allows the Income Tax Division to disclose information to the Customs and Excise Division of Treasury to assist in the performance of the duties of the latter. To date there is no legal cover for the flow of information from Customs and Excise to Income Tax. Legislation will be introduced to rectify this matter.

There are also provisions in place which enable information to be exchanged between the Income Tax Division and the Department of Health and Social Security in relation to matters within the benefits legislation and income tax legislation.

Since 7th July 1997, with the approval by Tynwald of the Social Security Administration (Fraud) Act 1997 (Application) Order 1997, there has been legal cover for the exchange of information, in both directions, between Customs and Excise and the Department of Health and Social Security (DHSS). Section 122 of the applied Act allows Customs and Excise to disclose to the DHSS information for the purposes of prevention and detection of benefit fraud and for use in civil or criminal proceedings under certain, named Social Security laws. Section 122 (c) of the applied Act allows DHSS to disclose information to Customs and Excise for use in assisting the Collector or an officer in the performance of his duties.

The Application Order relating to the Social Security Administration (Fraud) Act 1997 also extends to the Income Tax Division.

There are formal quarterly meetings between the Fraud Squad and compliance staff from the insurance companies and banks. In May, 1998, a liaison group was formed with representatives from the Fraud Squad, Financial Supervision Commission, Insurance and Pensions Authority, and Customs and Excise. The group meets monthly to consider matters of mutual interest.

The Police actively share intelligence at the investigation level with financial industry regulators. There are also occasions where fraud squad and the regulators mount joint investigations.

So far as the Courts are concerned, any information disclosed during public sittings of Court would be made available to law enforcement, regulatory and Tax Departments, upon request.

Both on their own initiative and in response to requests, the Island's regulatory authorities can and do provide information and assistance to other on-Island and off-Island regulators in response to specific requests. Except where the information forms part of the public record, it is not available for random examination and exploration by those outside the office of the regulatory body holding the information.

### 15.3 Sharing Information with Other Jurisdictions

The Attorney General's powers under sections 24 and 25 of the Criminal Justice Act 1990 can be used to assist overseas authorities in cases involving serious or complex fraud, wherever committed.

The Attorney General has further powers under section 21 of the Criminal Justice Act 1991 to assist Courts, Tribunals and investigating authorities in other jurisdictions. Under this power the Attorney General may apply to a stipendiary magistrate to order the production of evidence relating to a criminal investigation or criminal proceedings in other countries. When necessary a search warrant may be issued. The provisions are based on the Criminal Justice (International Co-operation) Act 1990 (an Act of Parliament). The provisions of Section 21 are used on a frequent basis and evidence in relation to all types of criminal offence is obtained in this way.

Special arrangements are in place under the Customs and Excise Agreement 1979 to enable Isle of Man Authorities and the UK Authorities to assist each other in relation to VAT and customs and excise matters.

Subordinate legislation made in relation to value added tax and customs and excise enables reciprocal assistance to be given to Member States of the European Community.

Under the terms of the Customs and Excise Agreement 1979, given legal effect in the Island by Orders made under the Customs and Excise (Transfer of Functions) Act 1979 of Tynwald and the Isle of Man Act 1979 of Parliament, and the Value Added Tax (United Kingdom) Order 1996, the Island and UK are treated as one area for Customs, VAT and Excise Duty Purposes. This permits the free flow of information between the two jurisdictions in Customs, Excise and VAT matters including information relating to offences.

The Isle of Man regularly obtains and shares intelligence with authorities outside the jurisdiction. This is often done on a informal basis as a precursor to more formal applications under, for example, the Criminal Justice Act 1990 or the Criminal Justice Act 1991.

Banks and financial institutions now regularly make suspicious transaction reports to the Police. These reports are promptly relayed to criminal intelligence organisations such as NCIS. The majority of suspicious transaction reports dealt with at present relate to funds where there is thought to be a possibility that they derive from drug trafficking.

The Criminal Justice (Money Laundering Offences) Act creates a number of new substantive offences in relation to the laundering of proceeds of crime other than drug trafficking. As part of the scheme of that Act, defences are created in certain cases if a transaction is reported to the Police. The new Act is likely to cause an increase in the number of suspicious transaction reports. Intelligence derived from these reports will be passed to appropriate criminal intelligence agencies.

The general powers to provide evidence for use outside the Island which are contained in section 21 of the Criminal Justice Act 1991 have no cut off point nor any general limitation on the class of offences to which they apply. Certain additional requirements are imposed where the offence is a fiscal offence and proceedings have not yet been instituted. The Act enables assistance to be given in genuine criminal cases, including tax crime, but does not extend to speculative enquiries by foreign tax authorities relating to tax collection. The section copies the law contained in section 4 of the Criminal Justice (International Co-operation) Act 1990 (an Act of the Westminster parliament). Under the Police Powers and Procedures Act 1998, the Police are given powers of entry, search and seizure in cases of serious arrestable offences. The powers can be used for the collection of information in respect of crimes committed outside the Island.

The Island is able to, and does, co-operate fully with the United Kingdom and other Member States of the European Community in customs matters. European Community law on mutual assistance in customs matters applies to the Isle of Man. Formal Co-operation Agreements entered into by the European Community with third countries and which have the force of community law extended to the Isle of Man.

The Island has voluntarily adopted the provisions of EC Directives on the mutual exchange of information and mutual recovery of value added tax and excise duties as between Member States. In particular, the EC Regulation 515/97 on mutual assistance in customs matters also allows for the introduction of the Customs Information System (CIS) data base on customs matters, for on line information exchanged between EC member states.

The Island voluntarily adopted EC regulation 218/92, and other associated instruments, in 1993 to allow for the exchange of information on EC acquisitions and dispatches between member states involving Island based businesses. This enabled the Island to function as a part of the single market for VAT purposes with effect from 1st January 1993.

Island law on data protection, in the manner of the application of data protection principles to manual records, will require addressing before the derogation granted to the United Kingdom (and hence the Isle of Man) expires in 2002.

The Isle of Man Income Tax authorities have no general powers for the collection of information for the benefit of tax authorities in other jurisdictions. Information gathered for the purposes of criminal investigations and criminal proceedings in respect of fiscal matters are dealt with in accordance with the standard English rules of international law. In cases where information can be given in accordance with those rules, the information will be obtained by the Attorney General, Police etc in the same manner as any other criminal case.

Customs and Excise have access to HM Customs and Excise intelligence systems and also contribute to those systems. The Isle of Man is also an associate member of FFIN. The position of officers of Customs and Excise as "constables" for the purposes of money laundering legislation has been clarified, and the exchange of information between the Fraud Squad and Customs and Excise can take place freely.

The confidentiality and information exchanged through the disclosure system is considered to be of paramount importance and great care is taken by those involved to ensure that any such information is handled with sensitivity. All police officers involved in the system are fully aware of the importance of confidentiality.

## Formal Requests to the Police for the obtaining of evidence for the benefit of other

**jurisdictions in 1997 [1]**

| *Class of Request* | *Request Received* | *Assistance Given* | *Proceedings Pending* | *Assistance Refused* |
|---|---|---|---|---|
| Drugs | 20 | 19 | 1 | |
| Terrorism | 1 | 1 | | |
| Fraud, Tax and other offences | 55 | 18 | 32 | 5 [2] |

[1] No figures available for earlier years.
[2] None of these were tax cases.

Whilst the Island has regularly assisted with enquiries from other jurisdictions into serious crime, the Island's experience of seeking and obtaining information from other jurisdictions has been generally disappointing. The Island has few examples where other jurisdictions have proved as helpful and responsive to enquiries as the Island itself has been.

### 15.4 Mutual Legal Assistance Treaties and Double Taxation Arrangements

*Mutual Legal Assistance Treaties*

The Island has decided, as a matter of principle, that any country with which the United Kingdom has a bilateral agreement on drugs should be the subject of an order made by the Department of Home Affairs under the Drug Trafficking Offences (Designated Countries and Territories)(Amendment) Order and that, generally, the Island should seek to be included in the Treaty.

The Isle of Man Government has agreed to be involved in the following:

- The Agreement between the United Kingdom and the U.S. Government concerning the investigation of drug trafficking offences and the seizure and forfeiture of the proceeds of drug trafficking was extended to the Island in September, 1992.
- Treaty between United Kingdom and Government of Romania concerning the restraint and confiscation of the proceeds and instruments of crime -extension requested, May, 1995.
- Treaty between the United Kingdom and the Government of Thailand on mutual assistance in criminal matters - extension requested, January, 1995.
- Mutual Assistance agreements in relation to drug trafficking - extensions requested in respect of United Kingdom agreements with 25 various jurisdictions.
- Council of Europe Convention on Mutual Assistance in Criminal Matters, 1959 - extension requested.
- Agreement between United Kingdom and Government of India concerning the restraint and confiscation of the proceeds and instruments of crime and terrorist funds, 1990 - extension requested, January, 1990.
- Legal Proceedings Convention:

  - United Kingdom/Belgium, 1932 -extended January, 1984

  - United Kingdom/Iraq, 1935 -extended January, 1984

  - United Kingdom/Hungary, 1935 -extended January, 1984

  - United Kingdom/Yugoslavia, 1936 - extended June, 1984

- United Kingdom/Switzerland, 1937 - extended June, 1981

- United Kingdom/Netherlands, 1932, 1967 - extended April, 1977

- United Kingdom/Romania, 1978 -extended June, 1978

- Investment promotion and protection agreements, extensions requested in respect of United Kingdom Agreements with 35 jurisdictions.

This list is sufficient to confirm the willingness of the Island to co-operate internationally in the safeguarding of international business and the pursuit of international crime.

*Double Taxation Arrangements*

The Island has only one major double taxation arrangement. This is with the United Kingdom and it dates from 1955. Under that Arrangement, the Island has the ability to exchange information with the United Kingdom for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes covered by the Order.

Regular exchanges do take place and the respective Revenue Authorities seek to provide early and comprehensive responses.

Being an early model, there are limitations on the provisions contained within the Arrangement. Informal discussions have taken place about the possibility of bringing it up to date.

# 16 JUDICIAL PROCEEDINGS

The approach of the Island authorities is that crime should be prosecuted whenever it is identified and there is sufficient evidence and a realistic prospect of conviction and there are tried and tested procedures to assist other jurisdictions by providing evidence for use in proceedings and for bringing prosecutions in the Island.

### 16.1 Domestic legislation

The range of penalties available in the Criminal Courts of the Isle of Man is broadly comparable to those available for similar offences tried by the English Criminal Courts. The Isle of Man Courts normally follow the sentencing policy and guidelines set for Courts in England.

The Extradition Act 1989 (an Act of the Westminster parliament), and Orders in Council under that Act, extend to the Isle of Man as part of Manx law. The procedure for extradition of persons in the Isle of Man is entirely governed by that legislation. The operation of the Act in individual cases is subject to extradition treaties, conventions and arrangements entered into by the United Kingdom and which extend to the Isle of Man. Extradition proceedings take place before a Stipendiary Magistrate in London.

Where necessary, criminal proceedings are backed up with civil applications, for example, applications for restraint orders or injunctions. The range of remedies available in, and the right of access to, the High Court in the Isle of Man are the same as those available in England. There is no special impediment to actions against fraudsters, money launderers or others involved in financial crime.

Since May, 1987, drug trafficking legislation has included power for the restraint and confiscation of the proceeds of drug trafficking offences. In 1990, similar powers were conferred on the Courts in relation to terrorist funds and the proceeds of other offences, including tax crime, which are triable on information (equivalent to English indictable offences).

In all these cases, the Isle of Man's Authorities have power to trace, restrain and confiscate the funds in question. The current powers are contained in the Criminal Justice Act 1990, the Prevention of Terrorism Act 1990 and the Drug Trafficking Act 1996. The powers are available for use, and are used, to assist other jurisdictions. The provisions have the same effect as the equivalent legislation in force in England.

The power of confiscation under the Criminal Justice Act 1990 is, in effect, an "all crimes" power. The power applies to offences which are triable on information (whether or not they are exclusively so triable) and lesser offences if prescribed by subordinate legislation. The Act applies to the same range of offences as the Criminal Justice Act 1988 (an Act of Parliament). There is no special provision which excludes specific tax offences or any other criminal offence (e.g. false accounting) which might relate to taxes. The powers of confiscation under the 1990 Act are exercisable where the criminal proceeds are at least 10,000.

In the case of suspected drug offences, terrorism, and other offences which are triable on information, the Island's Authorities have power to trace, restrain and confiscate the proceeds of crime. These powers are conferred by the Criminal Justice Act 1990, the Prevention of Terrorism Act 1990 and the Drug Trafficking Act 1996. The powers are used to assist other jurisdictions and the provisions have the same effect as the equivalent legislation in force in England.

The Criminal Justice (Money Laundering Offences) Act will add substantive offences to the existing armoury available in the Isle of Man against money laundering (see Section 13.2). Further legislation dealing with the confiscation of the proceeds of crime is in the list of forthcoming Bills.

The powers of confiscation etc under the Criminal Justice Act 1990 apply in relation to offences to which Part 1 of that Act applies. Part 1 of the Act applies to offences triable on information (whether or not it is exclusively so triable) and lesser offences which are prescribed by Order made by the Department of Home Affairs. The wording of the definition has the same effect as that contained in section 71(9)(c) of the Criminal Justice Act 1988 (an Act of Parliament) with the "gloss" of the Interpretation Act 1978 (an Act of Parliament). No special provision excludes tax offences or other criminal offences (eg false accounting) which might relate to taxes.

The legislation, in particular that contained in the Drug Trafficking Act 1996 and the Criminal Justice Act 1990, contain criminal procedures and civil law procedures. Both are used and both are designed to work in tandem with Isle of Man insolvency legislation.

In some cases physical assets as opposed to monies are restrained.

The range of remedies available in, and rights of access to, the High Court in the Isle of Man are the same as those available in England. There is no special impediment to actions against fraudsters, money launderers and financial institutions.

### 16.2 Assistance to Overseas Authorities

The vast majority of cases involving the restraint or confiscation of assets arises as a result of requests from other countries. Between 1992 and 1996, seventeen cases involving drug trafficking resulted in an amount of 2,324,200 being restrained or confiscated. In 1997, there was one case in which the amount restrained or confiscated was 7,000. Occasionally, physical assets as opposed to money have been restrained but values cannot be given.

The Judgments (Reciprocal Enforcement)(Isle of Man) Act 1968 provides for the registration and enforcement of foreign (including United Kingdom) judgements in the Isle of Man. But, in accordance with internationally accepted principles, certain foreign judgments for taxes and the like are not enforceable under that legislation.

As an earnest of the Island's willingness to act in response to requests from other jurisdictions, there is a long-standing arrangement with the Home Office that international agreements for mutual assistance in tracing, restraining, charging and confiscating assets held by suspects or convicted criminals should normally be extended to the Isle of Man. As a result of this policy, the principal multi-lateral mutual assistance treaties have been extended to the Island. A number of bi-lateral agreements have also been extended although, because of the large number of these agreements, the Home Office and the Foreign and Commonwealth Office have agreed between themselves to deal with extension in stages. The absence of a bi-lateral agreement extending to the Isle of Man does not affect Manx law. It is the practice of the Isle of Man Authorities to apply statutory powers to all countries with which the United Kingdom has an agreement. Further information can be found in Section 15.4.

# 17 SOME PARTICULAR CASES

*Savings and Investment Bank Limited (SIB)*

In 1982, the SIB, registered and licensed in the Isle of Man, collapsed with debts of some 37 million. Liquidators subsequently paid out dividends to depositors amounting to approximately 29p in the 1.00 and the Isle of Man Government instituted a one-off scheme of ex gratia payments to depositors from public funds, based on the United Kingdom Depositor Protection Scheme of the day. The scheme was aimed at helping the smaller depositor particularly.

SIB was a seminal experience for the Island and much of the regulatory system now in place and proposed can trace its origins to the SIB and its aftermath.

There was an immediate external review commissioned, undertaken by Bank of England staff, the principal result of which was the establishment of the Financial Supervision Commission in 1983 (see Section 5.4 (a) ). From this came, in turn, the Insurance Authority, now the Insurance and Pensions Authority in 1986 (see Section 5.4 (b) ). These may be seen as the first wave of response to SIB.

It took a number of years for the formal investigations and legal processes consequent upon the collapse of the SIB to be completed and for further lessons to be drawn. But in April, 1992, the Council of Ministers laid before Tynwald a report on certain aspects of Company and Trust Law. This report was the end result of the post-SIB reviews and may be said to herald the second wave of response to SIB. It proposed, in particular, the regulation of companies and trusts. The current proposals for the regulation of corporate service providers is the first element in the implementation of these proposals. The further initiatives proposed for the regulation of companies and trusts will follow in due course and in accordance with the Council of Ministers' report.

Also directly attributable to SIB was the decision of the Isle of Man Government to introduce legislation for investor protection funded by levies on regulated institutions (see Section 5.5).

*Bank of Credit and Commerce International (BCCI)*

On 5th July, 1991, international regulatory action co-ordinated by the Bank of England led to the closure of the BCCI group. There was a branch of BCCI on the Island and, following the winding up of BCCI, payments to depositors of the Isle of Man branch have been the only calls on the Island's Depositors' Compensation Scheme.

Notwithstanding the activities of BCCI and its officers elsewhere in the world, there is no evidence from the investigations of the Island's authorities and those from elsewhere that the Isle of Man branch was anything other than properly run.

The high standard of regulation on the Island and the depositor protection arrangements have served to ensure that the Island has not been implicated in the more reprehensible aspects of BCCI's activities and has been seen to respond responsibly and sympathetically to the interests of depositors.

*Mil-Tec Corporation Limited (Mil-Tec)*

In late 1997, media reports linked British companies, including Mil-Tec registered in the Isle of Man, to the supply of arms, in contravention of the U.N. embargo, to Rwandan extremists in Zaire. The situation was the subject of a United Kingdom inter-departmental committee report. This revealed that, consequent upon failures in communication between two United Kingdom Government Departments, the necessary subordinate legislation had not been put in place and that there was a gap

in controls.

Whilst the failure to apply the U.N. sanctions was not attributable to any failure on behalf of the Island authorities, there was significant adverse publicity and public reaction to the activities of the company which affected adversely the reputation of the Island.

The Mil-Tec incident and the public response has been material in strengthening the resolve of the Isle of Man Government to institute appropriate and effective regulatory arrangements in respect of Manx registered companies.

*The Agip case*

An employee of Agip (Africa) Limited (Agip) misappropriated money from Agip and diverted it to recipients of his own choosing through companies which were provided and managed by a firm of Accountants in the Isle of Man.

In the circumstances of the case, one Accountant and his employee were judged by the U.K. Courts to be liable as constructive trustees and the other Accountant, who played no part in the fraud, to be liable for the acts of his partner Accountant and the employee of his firm.

# ANNEX

## PRINCIPAL LEGISLATION RELATING TO FINANCIAL REGULATION, COMPANIES AND TRUSTS, CRIME, MONEY LAUNDERING AND FORTHCOMING LEGISLATION

## FINANCIAL REGULATION

**Insurance Act 1986**

The Act provides for the regulation of insurance companies. Insurance business is not permitted unless a company is authorised by the Insurance and Pensions Authority or is authorised in a member State of the European Community and is the holder of a permit issued by the authority. Insurers must maintain proper solvency and accounting standards. The Authority has powers require information, to carry out investigations and to wind up insurers.

**Building Societies Act 1986**

Under the Act building societies cannot accept deposits or subscriptions for their shares nor can they make loans or advances unless the society is authorised by the Financial Supervision Commission. The Act contains powers for the Commission to require information about the affairs of a building society.

**Financial Supervision Act 1988**

Collective investment schemes are regulated under this Act. Only schemes which are authorised or recognised by the Financial Supervision Commission may be promoted in or from the Island. Subordinate legislation regulates the constitution, solvency and administration of collective investment schemes.

Enabling powers under the Act have been exercised to make compensation schemes for participants in collective investment schemes and policyholders.

**Investment Business Act 1991**

Investment business is regulated and supervised by the Financial Supervision Commission under this Act. Only permitted persons may carry on investment business. The Commission has powers to require information, investigate the affairs of investment businesses and to issue enforceable directions to those carrying on investment business. Subordinate legislation provides specific rules as to the conduct of investment business.

**Moneylenders Act 1991**

The Act provides for the regulation of persons carrying on the business of money lending. Moneylending cannot be carried on unless the business is registered with the Board of Consumer Affairs. The Board has powers to obtain evidence of

infringements by means of search warrants.

**Credit Unions Act 1992**

The Act regulates the establishment, registration and operation of credit unions and the Financial Supervision Commission is responsible for their supervision. The Commission has powers to require information, to suspend the operations of credit unions and to issue enforceable directions to credit unions.

**Timeshare Act 1997**

This Act provides for the regulation of timeshare agreements and timeshare credit agreements where there is some connection with the Isle of Man. The Act requires safeguards to be included in timeshare contracts and imposes a "cooling off" period. Enforcement is undertaken by the Board of Consumer Affairs.

Subordinate legislation provides detailed rules as to the carrying on of timeshare business.

**Banking Act 1998**

This Act consolidates existing legislation and adds improved enforcement powers. Banking business may not be carried on in or from within the Isle of Man without a licence granted by the Financial Supervision Commission. Licence-holders are required to be fit and proper.

The Commission has powers to obtain information, investigate the affairs of banks and issue enforceable directions to banks.

A scheme of compensation for depositors has effect under the Act.

# COMPANIES AND TRUSTS

**Companies Act 1931**

The Companies Act 1931 provides for the incorporation of companies in the Isle of Man. The Act is based on the Companies Act 1929 (of the Westminster Parliament) but is much amended to reflect changes in commercial practices and regulatory needs.

The Act gives the High Court the power to appoint inspectors to investigate the affairs of companies. The inspectors report back to the High Court.

**Trustee Act 1961**

This Act is based on the Trustee Act 1925 of Parliament. Part I of the Act regulates the investment powers of trustees. Part II deals with the general powers of trustees, the delegation of powers by trustees and protective trusts. Part III regulates the appointment and discharge of trustees. Part IV provides for the powers of the court to appoint trustees and for vesting of trust property in trustees and the powers of the court to deal with trust property.

The Act is supplemented by legislation relating to the variation of trusts, charitable trusts and the governing law of trusts.

**Companies Act 1968**

This Act updated the system of prospectuses for public offers.

**Companies Act 1974**

The Act made a number of amendments to the Companies Act 1931. It enables the Treasury to apply to the High Court for the appointment of inspectors in the public interest or where the company has been used for an unlawful purpose or persons concerned in its formation or management have been involved in misconduct. The Act also prohibited corporate directors.

**Companies Act 1982**

The principal effect of the Act was to update the accounting requirements of the 1931 Act. In addition new requirements were made for the appointment of directors and secretaries.

The Act enables the High Court to order that the directors of an insolvent company shall not be directors of, or involved in the management of, any company. Disqualification can last for 5 years.

**Companies Act 1986**

The principal effect of this Act was to permit companies to undertake any legal business without the need for the extensive recital of objects in a memorandum of association. The Act largely abolished the ultra vires rule for companies.

**Companies Act 1992**

The Act made extensive amendments to the existing law in the field of mergers and reconstructions, financial assistance by a company for the purchase of its own shares, the purchase by a company of its own shares, registry practice, administration of companies and private companies.

Power is also given to the High Court to order that an unfit individual shall not be a director, secretary, liquidator, receiver or manager of a company, or to be involved in the promotion, formation or management of a company for 3 to 15 years. The grounds for making an order include - conviction for dishonesty (anywhere), conviction of 3 offences under the Companies Acts or similar overseas legislation, conviction of an offence relating to regulation of the financial services industry (anywhere), or failure to comply with certain orders of the High Court. Disqualification can be imposed for periods from 3 to 15 years.

**Recognition of Trusts Act 1988**

This Act implements the Hague Convention on the recognition of trusts.

**Single Member Companies Act 1993**

This Act enabled the establishment of companies having one member. Until 1993 the minimum number of members that a company could have was two. The Act made specific modifications to the Companies Act 1931 for the purpose.

**Purpose Trusts Act 1996**

This Act permits the establishment of trusts for a specific purpose rather than for the benefit of a particular beneficiary.

**Companies (Transfer of Domicile) Act1998**

Part I of the Act enables foreign companies to re-establish in the Isle of Man as if they were companies incorporated in the Isle of Man under the Companies Acts 1931 to 1993. Such companies will, after re-establishing, be treated for all purposes as the same as Isle of Man incorporated companies.

Part 2 of the Act permits companies incorporated in the Isle of Man under the Companies Acts 1931 to 1993 to re-establish in other jurisdictions.

**Limited Liability Companies Act 1996**

The Act provides for the establishment, registration, accounts, administration and winding up of a new form of association called a limited liability company. The form is based on a concept which is well known in the United States of America. It embodies principles from both partnership and company law. The liability of the organisation is limited and operates in a similar manner to a body corporate but in other respects it resembles a partnership, for example it is tax transparent (the members are liable for taxes on the income of the company).

# CRIMINAL LEGISLATION

**Criminal Code 1872**

This Act includes the offence of conspiracy to cheat and defraud.

**Bankers' Books Evidence Act 1935**

This Act enables a court to require a bank to allow a party to any civil or criminal proceedings to inspect and take copies of a banker's records.

**Misuse of Drugs Act 1976**

The sale, supply, import, production, etc. of restricted drugs are controlled under this Act in the same way as in the United Kingdom. In particular offences are created which apply to ships registered in the Isle of Man and foreign ships. The Act contains powers for constables, customs officers and other authorised persons to stop and search ships.

**Criminal Law Act 1981**

This extensive Act includes powers for criminal courts to deprive convicted persons of property used or intended for use for the purposes of crime. Section 32 of the Criminal Justice Act 1991 extends the power to enable assistance to be given for the enforcement of similar orders in other countries.

**Corruption Act 1986**

This Act creates offences in relation to corrupt transactions and includes transactions by Isle of Man residents while outside the Island. There is a rebuttable presumption that gifts, etc to members and servants of public bodies are corrupt.

**Summary Jurisdiction Act 1989**

This Act governs the operation of courts of summary jurisdiction in the Isle of Man. It includes powers for the police in the Island to execute warrants issued in UK or Channel Islands. The power applies to warrants of arrest or commitment issued by courts, judges and magistrates.

**Prevention of Terrorism Act 1990**

The Act closely follows the United Kingdom legislation on the subject. Part 3 makes it an offence to give financial assistance for terrorism, to certain terrorist organisations and to assist in the retention of terrorist funds.

The Act contains detailed powers in relation to the investigation of terrorist activities and organisations and the tracing and seizure of terrorist funds. Enables a police constable to obtain access to material which is relevant to a terrorist investigation under an order made by a judge. It is an offence to fail to pass to the police information about suspected acts of terrorism.

**Criminal Justice Act 1990**

Part 1 (Sections. 1 - 22) : Enables a criminal court in the Isle of Man to order the confiscation of the proceeds of crime. The power is exercisable when a person is convicted of certain criminal offences. There are also powers to restrain the proceeds of crime pending the making of a confiscation order. The powers may be used to assist overseas authorities.

Part 2 (Sections. 24 - 25) : Confers on the Attorney General for the Isle of Man the power to require any person to provide information in relation to serious or complex fraud. The power is available to assist overseas authorities.

**Criminal Justice Act 1991**

This Act includes procedures for obtaining information, documents and evidence for use by courts and investigating authorities outside the Isle of Man. The information is obtained before a court on the application of the Attorney General.

Rules are provided for the service of external process in the Isle of Man and the Act also allows the Isle of Man to provide assistance in the enforcement of forfeiture orders made by overseas courts in respect of the modalities of crime.

**Drug Trafficking Act 1996**

This Act follows very closely the Drug Trafficking Act 1994 (an Act of the Westminster Parliament).

It enables a criminal court in the Isle of Man to order the confiscation of the proceeds of drug trafficking. The power is exercisable when a person is convicted of a drug trafficking offence. Powers are included to trace and restrain the proceeds of drug trafficking pending the making of a confiscation order. The powers may be used to assist overseas authorities.

The police and to customs and excise officers are given powers to seize cash which is being imported or exported and which is believed to be the proceeds of drug trafficking.

The Act also contains a number of offences relating to the laundering of the proceeds of drug trafficking.

**Police Powers and Procedures Act 1998**

The Act is based on the Police and Criminal Evidence Act 1984 (an Act of the Westminster Parliament). It deals with a broad range of police powers but includes provisions for the issue of search warrants to the Police to obtain information and to seize articles. The powers can be used to obtain evidence in respect of crimes committed inside and outside the Isle of Man.

**Criminal Justice (Money Laundering ) Act 1998**

The Act amends the Prevention of Terrorism Act 1990 and the Criminal Justice Act 1990 to bring offences relating to the laundering of terrorist funds and the proceeds of crime into line with the provisions currently in force in the United Kingdom.

New offences relating to "all crimes" money laundering are created and powers are conferred to make anti-money laundering codes which will set down rules as to the systems, training and business practices to put in place by businesses which handle money.

**Insider Dealing Act 1998**

This Act creates offences relating to the misuse of inside price sensitive information and replaces the Company Securities (Insider Dealing) Act 1987. The Act provides powers for the Treasury to appoint inspectors to investigate cases of suspected insider dealing. The inspectors report to the Treasury and have powers similar to those conferred on inspectors appointed under the Companies Acts to investigate the affairs of companies. The Treasury may publish the reports or evidence contained in them.

# INSOLVENCY

**Bankruptcy Code 1892**

This Act establishes the substantive rules for the bankruptcy of individuals. Part I sets out the nature of acts of bankruptcy and the consequences of an adjudication of bankruptcy. Part II describes the disqualifications to which a bankrupt is subject. Part III deals with the administration of the property of a bankrupt, the effect of the bankruptcy on antecedent transactions. Part IV provides for trustees in bankruptcy, the trustee's accounts and the release of the trustee. The Act also deals with deeds of arrangement and fraudulent debtors.

**Bankruptcy Procedure Act 1892**

This Act provides the rules for the regulation of court practice and procedure in bankruptcy and associated matters.

**Companies Act 1931**

Part V deals with the liquidation and winding up of companies. The Act sets out the modes of winding up (i.e. by the court, voluntary or subject to the supervision of the court). Compulsory winding up is usually undertaken where the company is unable to pay its debts but also arises where the court is satisfied that it is just and equitable or where it is in the public interest.

The Act provides for the appointment and regulation of liquidators, the powers of the court, the liquidation of the companies assets, payments to creditors, priorities and the dissolution of companies.

**Bankruptcy Act 1988**

This Act confers statutory powers on the High Court to assist bankruptcy courts from other jurisdictions.

# PROPOSALS FOR LEGISLATION IN 1998/99

**Anti-Money Laundering Code**

A draft code has been prepared under the enabling powers conferred by the Criminal Justice (Money Laundering Offences) Act 1998. The draft sets out anti-money laundering measures to be taken by businesses to recognise and prevent money laundering. The Code will apply to a wide variety of businesses such as banks, insurers, building societies, bureaux de change, casinos, lending institutions, professionals, etc. It is expected to come into operation on 1 October 1998.

**Corporate Service Providers Bill**

Proposals for legislation to licence and regulate corporate service providers [e.g. company formation agents and those providing professional company secretary services] are currently subject to public consultation. A Bill is expected to be introduced early in the 1998/99 session.

**Insolvency Bill**

This project will revise the current law relating to the winding up of the affairs of insolvent companies. The proposals are likely to result in new law relating to corporate rescue, updating of current law and procedures and the introduction of new provisions giving a more proactive role to the office of Official Receiver. This Bill is included in the current 1998/99 session programme.

**Pensions Bill**

This Bill is in the process of drafting. It will provide a system for the authorisation of pensions schemes on a similar basis to the system in place for collective investment schemes. The enforcement authority will be the Insurance and Pensions Authority which will have extensive investigation and enforcement powers.

*9 Insurance and pensions business*

S75 Guernsey and the Isle of Man have large offshore insurance sectors, mainly providing *captive and life insurance products* to non-resident customers. Jersey has only recently begun to compete for such business. (9.2)

S76 The Islands have *designated territory status* under section 130 of the UK's Financial Services Act, 1986. This enables their life insurance companies to market their products to UK residents. (9.2.9)

S77 The Island authorities are all *committed* to have well-regulated insurance sectors, suitably attuned to offshore needs. Although the emphasis of the supervisory regimes is on the insurers themselves and their Directors, the authorities implement the supervision on a day to day basis mainly through *local specialist insurance management companies*. (9.5-9.6)

S78 In the Islands as elsewhere, insurance regulators have tended to play a larger part than banking or investment regulators in *supporting the industry's progress* and developing new products. **In my opinion, this is acceptable but only provided that the regulators scrupulously respect the principles set out in section 6.** (9.7 (a))

S79 The Island supervisors rightly take full responsibility for supervision of all insurance companies operating on the Islands, while looking to supervisors in the parent companies' jurisdictions to exercise consolidated supervision. **In my opinion, there is a presumption in favour of having explicit agreements with the supervisors in parent company jurisdictions.** (9.7 (c))

S80 The *legislation* in all the Islands covers the differing needs of (and within) the domestic and offshore sectors by giving wide discretion to the regulators, including significant "waiver" powers. (9.8)

S81 The authorities are reviewing their legislation. **There may be a case for a new structure comprising separate laws for the domestic and offshore business and, within the offshore business law, separate provisions for captive and commercial business and life insurance business.** (9.8)

S82 **The Isle of Man and Jersey authorities will wish to deal at the same time with the other issues on the legislation listed in Chapter 9. In Jersey, particularly, there are some significant issues to be considered.** (9.8)

S83 The Guernsey authorities introduced legislation in 1997 for *Protected Cell Companies*. Such structures offer economies in administration, fees and capital requirements for insurance and investment funds. Where the assets are held in jurisdictions outside Guernsey, however, there is no knowing whether Courts outside Guernsey would accept such structures or set them aside. The Guernsey supervisors have rightly been scrupulous in highlighting this uncertainty. **They should continue to ensure that firms offering the facility are similarly scrupulous.** (9.9)

S84 The Island authorities *vet* applications for licences carefully with a view to admitting quality. On-going supervision depends importantly on scrutiny of annual returns, including audited annual accounts, reports by consulting actuaries and auditors, and business plans. As in the UK, on-site inspections are not well developed. (9.10-9.11)

S85 **Chapter 9 lists *matters which seem to require attention* in one or more of the Islands**, including accounting standards, updating of business plans, solvency margins, actuarial criteria and certificates, whistle-blowing and procedure manuals. **Also crucial, especially in long-term insurance, are systems for combating money laundering.** The Isle of Man authorities require that the annual Directors' Certificate and Auditors' Report certify full and effective compliance with the Island's money laundering guidelines. (9.11)

S86 The authorities' powers to *investigate, intervene and petition for winding up* of insurers appear satisfactory. (9.12)

S87 The Jersey authorities' powers to *co-operate with overseas authorities* are subject to certain restrictions. As discussed in Chapter 6, **the authorities may wish to remove these**. (9.13)

S88 The Isle of Man is alone among the Islands in having a statutory life insurance *policyholder protection* scheme. The Jersey and Guernsey authorities have alternative trust arrangements which have been approved for the UK designated territory requirements. (9.14)

S89 The pension products currently offered by insurers on the Islands are in effect savings vehicles. None of the Islands has special legislation or supervision for *offshore pension schemes*. The Isle of Man is developing such a regime. The Guernsey authorities, too, are considering the matter. Such supervision could require considerable resources. (9.15)

S90 **The Island authorities should give *priority* to ensuring that the supervisory regimes for longer term products, especially life assurance, are well-judged, effective and up to date.** These are the products where the public are at risk. (9.16)

S91 **Within the captives area, supervision of *third-party business* should receive special priority.** (9.16)

S92 The insurance supervisors in Guernsey and Isle of Man both propose, rightly in my opinion, to add one additional analyst (net) to their staff. (9.17)

*10 Companies*

S93 The Islands have developed large businesses as international *company registration and administration centres*. Around 90,000 companies are incorporated in the Islands. The Isle of Man has the largest number. Jersey and Guernsey have been more selective. Especially in Jersey and Guernsey, however, many more companies are administered from, but not incorporated in, the Islands. (10.1)

S94 The Islands' company sectors differ markedly from those of the onshore jurisdictions. Most companies are *private companies* formed by non-resident individuals or Trusts to hold assets of various kinds or business interests outside the Islands. Pyramid structures, with a Trust at the top owning a variety of companies, are common. As in other offshore centres, these companies have been a source of concern to the Island authorities because of the potential they offer for concealment of disreputable purposes and the risks of bad publicity. (10.1-10.2)

S95 For *multinational or overseas companies*, the Islands' company vehicles may offer substantial advantages in tax savings and convenience. Such vehicles are used for purposes such as headquarters, treasury and international trading functions, captive and life insurance, collective investment funds, share option and pension funds, and leasing as well as other forms of asset holding. (10.2)

S96 *Corporate service providers* (CSPs), including company formation agents and managers, play a key role in the Islands. They are responsible for most company formations. They also provide Director, management, administration and company secretary services for many companies. (10.2)

S97 *Company registration and regulation regimes* in the Islands are designed, as elsewhere, to give companies a legal identity and, if they so choose, limited liability, in return for making available certain basic information. (10.6)

S98 The regimes differ between the Islands and between the Islands and the UK. The authorities in Jersey and Guernsey, but not the Isle of Man, vet applications for new company registrations and require confidential disclosure to the authorities of the company's *beneficial ownership*, where this differs from the nominal ownership. Unlike the Isle of Man and the UK, however, they have not in the past required *companies operating in or from the Islands but incorporated elsewhere* to register. In none of the Islands are private limited companies required to publish accounts or an Annual Report by the Directors. (10.6)

S99 For the reasons explained in Chapter 10, **the case in favour of vetting is, in my opinion, strong**. There is great scope for abuse of company vehicles to facilitate financial crime and money laundering. Company regulation and law enforcement need to work together to combat crime. (10.7)

S100 **The case for requiring disclosure of beneficial ownership in confidence at registration (as in Jersey and Guernsey), and changes subsequently (not a universal requirement in either Island), is likewise compelling.** The authorities need to know who the principals behind the companies using their centres are. **I hope that the Jersey and**

**Guernsey authorities will modify their existing arrangements so as to require all companies to report changes in beneficial ownership.** (10.8)

S101 **I hope that the Isle of Man authorities will seriously consider introducing vetting and a requirement for confidential disclosure of beneficial ownership, with subsequent reporting of changes, as outlined above.** (10.7-10.8)

S102 **Companies administered or otherwise operating in the Islands, but incorporated elsewhere, should be subject to a registration and regulatory regime similar to that for locally incorporated companies.** Without this, local registration and regulatory requirements are easily avoided. **The Jersey, Guernsey and Alderney authorities are rightly planning to make this change. The Isle of Man authorities, too, may wish to ensure that their coverage of companies incorporated elsewhere is comprehensive as well as adding the requirement for confidential disclosure of beneficial ownership.** (10.9)

S103 **In my opinion, there is likewise a strong case for requiring all limited companies to prepare and file audited accounts in accordance with EU practice.** Without this, the nature, scale and purpose of individual companies are likely to remain opaque. **Such a requirement would best be introduced as part of a wider initiative across all centres, onshore and offshore. In the meantime, there are intermediate options that would be valuable, such as confidential disclosure of abbreviated information to the authorities, either automatically or on request. I hope that the Island authorities will consider these.** A requirement to *submit* accounts, even a single-page summary, is much the best way to enforce the requirement to *keep* accounts. (10.10)

S104 The authorities' new policies for licensing and regulating company service providers (see section 13) should be seen as complementing, not replacing, the strengthened company regulation regimes. (10.11)

S105 Like other offshore centres, the Islands offer non-residents *special company tax regimes* designed to attract international business, notably tax exempt companies and international business companies. In recent G7, OECD and EU discussions, the industrial countries have suggested that this is harmful tax competition. This issue will have to be discussed at an international level. The Islands have made clear that they wish to play a full and constructive part in global discussions. (10.12-10.13)

S106 In the meantime, Jersey and Guernsey have a special category of *foreign registered investment companies* which are subject to reduced regulatory requirements. **In my opinion, the same regulatory regime should apply to all companies associated with the Islands.** (10.12)

S107 The Isle of Man has a special category of *locally incorporated non-resident companies*. Locally incorporated but managed and controlled outside the Island and therefore not liable to Island tax except for an annual duty of 750, these vehicles have been criticised as helping their owners to avoid or evade tax in other jurisdictions while hiding their identities. **The authorities are considering whether to abolish the category. I am sure they will be right to do so.** (10.12)

S108 **In my opinion, there is a presumption against permitting bearer shares.** Such instruments may facilitate money laundering. Jersey, Guernsey and Alderney do not permit them for locally registered companies. The Isle of Man, like the UK, permits warrants which resemble bearer shares. (10.14)

S109 Jersey, like the UK, has modern procedures for dealing with *bankruptcies and corporate insolvencies*. **Some of the Isle of Man, Guernsey and Alderney procedures need updating. The authorities are planning new legislation to tackle this.** (10.15)

S110 **The authorities in all the Islands are considering, rightly in my opinion, the introduction of modern procedures enabling businesses to be rescued, when appropriate, rather than made insolvent.** Companies might be allowed to obtain a moratorium on action by creditors for (say) 28 days. (10.16 (a))

S111 **The Guernsey and the Isle of Man authorities are also considering, again rightly in my opinion, the introduction of a new public body with responsibility for carrying through the practical business of insolvency in public interest cases.** The Official Receiver in England and the Viscount in Jersey offer possible models. (10.16 (b))

S112 **The new body should preferably also have responsibility for ascertaining access to assets held in Trust and for licensing and supervision of insolvency practitioners.** (10.16 (b))

S113 Chapter 10 includes a *checklist of further issues* which I hope the Island authorities will consider when updating their insolvency and bankruptcy regimes. (10.17)

*11 Directors and partnerships*

S114 As in the UK, the Islands' company legislation lays certain *duties and obligations* on Directors of companies. Such legislation needs to lay on Directors individually duties and responsibilities which cannot be ducked through general powers of attorney, and to give the authorities wide powers, not confined to insolvency cases, to disqualify Directors. (11.1)

S115 The Islands have most of this in place already. **The legislation could usefully be extended, however, to provide for enforceable *Codes of Conduct* for Directors. It should also apply to *Directors of companies operating in the Islands but not incorporated there.*** (11.1)

S116 **With regard to the *disqualification* of Directors, maximum disqualification periods might preferably be standardised at 15 years.** (11.1)

S117 **The authorities need not only to have disqualification powers but also to use them.** Enforcement has so far been limited. Some official person or body needs to have the responsibility, and the funding, to launch disqualification procedures in public interest as well as insolvency cases. (11.1)

S118 The reputation of all the Islands has suffered from the presence on the Islands, especially Sark, of so-called *"nominee" Directors* of companies. These Directors know little or nothing about the companies they nominally direct. Owners of assets or business interests in other jurisdictions have found that they can combine secrecy with tax-free status by forming non-resident companies in (say) the Isle of Man with "Directors" (and hence residence for tax purposes) in (say) Sark (where there is no tax and no company regulation). (11.2)

S119 **The authorities in Guernsey, Alderney and Sark are agreed that the problem must be solved by means of new legislation with application throughout these three Islands. The aim is to have this in place by the end of 1999.** (11.2)

S120 Such legislation needs in my opinion to provide for the Guernsey FSC to license as fit and proper all those in the Islands who serve as Directors or trustees by way of a business. It should also provide for a *Code of Conduct for Directors* setting out the standards of conduct and diligence expected from them. The FSC should have the power and the duty to *enforce* these requirements. Directors without a fit and proper track record and Directors who fail to comply with the Code of Conduct would have their licences withdrawn or not be licensed in the first place. (11.2)

S121 The Jersey authorities have introduced a framework for *Limited Liability Partnerships*. In such partnerships, liability extends to the personal assets of a partner who is negligent or otherwise made liable but not to those of the other partners. **In my opinion this form of vehicle, which will be available only to very large partnerships, should be subject to the same regulatory requirements as public companies, including auditing and disclosure of accounts.** (11.4)

S122 The Isle of Man offers a company vehicle, somewhat confusingly called the *"Limited Liability Company" (LLC)*, based on US models, which combines the limited liability of companies with the tax treatment of partnerships. The issues these vehicles raise are similar to those which arise on other companies in the Isle of Man. (11.4)

*12 Trusts and trustees*

S123 Trusts are an important element in the Islands' international finance centres. Trust and company vehicles taken together enable the Islands to offer a range of facilities not generally available outside the Anglo-Saxon jurisdictions. The Islands are able to offer a favourable tax environment for both Trust and company vehicles. (12.2-12.6)

S124 For the most part, the Islands appear to have as good a *legal framework* for Trusts as any other jurisdictions, and better than most. The framework is broadly similar to that in the United Kingdom. In Jersey and Guernsey, however, Trust Law has since the 1980s had a mainly statutory basis. The Isle of Man's Trustee Act 1961 is based on the UK's Act of 1925. (12.7)

S125 **The Islands have rightly not followed certain other offshore centres in bringing in new legislation like the Cayman legislation for STAR Trusts or so-called Asset Protection Trusts.** In the Islands, as in the UK, such Trusts would be ineffective. (12.2)

S126 Trust instruments offer great advantages. But the scope for abuses, both by settlors and by trustees, is also great. As Trusts age, moreover, the scope for abuses by trustees multiplies. The need to ensure proper accountability is paramount. **Trustees should therefore be obliged to make proper disclosures to beneficiaries and, as appropriate, objects of a discretionary power, and to produce, submit and preserve suitably audited accounts.** (12.5-12.6)

S127 Professor David Hayton has identified a number of specific improvements that might be made in the Islands' Trust legislation. **I hope that the Islands will consider these.** (12.8)

S128 **To counter potential abuses by *settlors***, he has suggested **legislative provisions to reduce the scope for**

- **defrauding creditors,**
- **frustrating legitimate claims of heirs and spouses, and**
- **implementing "flee" clauses of a disreputable kind.** (12.8.2)

S129 **To counter abuses by *trustees***, he has suggested that the **legislation should:**

- **ban sole trustees (except in the case of properly constituted Trust companies with adequate paid-up capital or personal indemnity and employee fidelity insurance);**
- **oblige trustees to keep beneficiaries and, if there are fewer than two beneficiaries, three or more representative objects of a discretionary power, informed about the Trust;**
- **prohibit clauses exempting trustees from negligence of any kind;**
- **require waiver by future trustees of the privilege against self-incrimination; and**
- **make Purpose Trusts subject to inspection by an official enforcer.** (12.8.3)

S130 He has also endorsed a suggestion by Mr Peter Willoughby that, **for the avoidance of doubt, the Jersey, Guernsey and Alderney Trust Laws should provide that the equitable maxims and remedies of English Law underpin the Islands' as well as English Trust Law.** (12.8.4)

S131 The Island authorities have no proposals to register or regulate Trusts as such. But they all propose to *extend the regulatory boundary* to include professional providers of Trust and trustee services. The Jersey and Guernsey authorities propose to introduce legislation within the next 12 months, with a view to implementing the new regimes in 2000. The Isle of Man authorities propose first to bring in proposals for regulation of company service providers before proceeding to Trust service providers. (12.9)

S132 **In my opinion, the Island authorities are entirely right to extend the regulatory boundary. They are also right to focus the regulatory regime on Trust service providers rather than Trusts themselves.** (12.9)

S133 **The legislation should preferably require the FSCs to vet, license and regulate Trust Service providers and to promulgate an enforceable Code of Conduct. The FSCs should have investigation and enforcement powers, including powers to refuse or revoke licences. It should be an offence to provide such services without registration.** Chapter 12 includes some illustrative sketches for the legislation and the Code. (12.10)

S134 As discussed in Chapter 12, the *transition* from non-regulation to regulation will require careful handling. **In my opinion, the initial registration process should set high standards and should be used to weed out dubious or incompetent providers.** (12.11)

S135 The considerations that point to regulating Trust services providers in the Islands seem equally cogent in the UK. Such a step could have the added advantage of bringing together for the first time a group of people inside the UK Government, or the Financial Services Authority, with a clear responsibility for overseeing the Trust sector. (12.12)

*13 Company, Trust and professional service providers*

S136 **The Island authorities have all committed themselves, rightly in my opinion, to license and regulate the providers of company as well as Trust services.** This is perhaps the only effective way to regulate the Islands' large company and Trust sectors. (13.3)

S137 The objectives should be:

- **to protect the Islands' customers by preventing fraud and other disreputable activity by providers;**
- **to promote high standards of business conduct and competence;**
- **to combat abuse of the Islands' Trust and Company facilities by customers wishing to launder money or commit other forms of crime;**
- **to ensure that providers do not facilitate or acquiesce in such abuses;**
- **to put the bad providers out of business; and,**
- **by all these means, to protect the Islands' reputations.** (13.5)

S138 The Islands' proposals envisage different *legislative structures*, regulatory coverage and frameworks, and timetables. (13.6)

S139 **In my opinion, a convenient structure is likely to be a single piece of overarching legislation, providing for the registration and regulation of all service providers, supported by specific rules or Codes of Conduct for each of the main areas, notably Trust services, company services, Director services and other specialist services.** (13.6)

S140 **In my opinion, again, there is a presumption that all companies, other than those licensed by the FSCs or trading companies formed by residents to serve residents, should be obliged to use a licensed provider.** (13.7 (b))

S141 **The authorities should set high standards from the outset and refuse to license questionable providers. The requirement for licensing should apply to all who provide Trust or Company services. There should be no exemptions for particular institutions, professional qualifications or small scale of activity. It should be an offence to act as a provider by way of business without being properly licensed. Providers should be obliged to maintain adequate levels of professional indemnity and employee fidelity insurance.** (13.7 (a), (c), (i))

S142 **The FSCs should have duties and powers to issue and withdraw licences, to attach conditions, to inspect and investigate, (preferably) to impose fines, and to police unlicensed business. They should be allowed to use their own staff for these purposes as well as outsiders.** (13.7(h))

S143 **Provision should be made, as the Island authorities are now envisaging, for a serious but sensible measure of proactive as well as reactive enforcement, including some on-going inspection of the licensed population.** (13.7(h))

S144 **In the early stages at least, the FSCs are likely to need between four and six staff, carefully chosen, to introduce and implement the new regulation.** (13.7(l))

S145 The Islands have substantial numbers of resident *lawyers and accountants* to serve the heavy requirements of their international finance centres. Those who provide Trust, company and investment services will rightly be obliged to apply for licences and submit to regulation just like other providers. (13.8)

S146 **The Islands have also been concerned to apply appropriate professional disciplines to lawyers and accountants acting in their professional capacities. In my opinion this is the right policy.** The scope for abuse exists in these areas as well. (13.8)

S147 Lawyers are regulated by the Island Courts and/or Law Societies. Accountants are mostly regulated by the UK's

accountancy bodies. (13.8)

S148 **Such regulation needs in my opinion to apply comprehensively to *all* practitioners practising in the Islands. It should make it as difficult as possible for any practitioner to engage in, facilitate or acquiesce in disreputable activity, either by the providing firm or by its clients. It should cover the handling of client accounts, including the provenance as well as the potection of client monies, and the need for adequate professional indemnity and employee fidelity insurance** (13.8)

S149 The UK Government is committed to publish later this year detailed proposals for a comprehensive framework for independent regulation of accountants. **I hope that the Islands will consider whether the new framework, when it appears, fully meets the requirements of their finance centres and how it, or something similar, could be applied in the Islands.** (13.8)

*14 Financial crime and money laundering: policy and legislation*

S150 **The authorities in all the Islands have made clear their firm commitment to prevent, deter and combat crime of all kinds, wherever committed, including money laundering and tax evasion as well as drug trafficking, terrorism and fraud. They are committed to the fullest co-operation with other jurisdictions to that end.** (14.1)

S151 All the Islands have a policy to comply with the Forty Recommendations on combating money laundering of the international Financial Action Task Force (FATF), revised in 1996. (14.2)

S152 I have no doubt that most of the Islands' business is perfectly legal. In common with other finance centres, however, both offshore and onshore, the Islands face challenges in the field of financial crime, including tax evasion and money laundering. The extent of the problem is hard to judge. Chapter 14 discusses this. (14.3)

S153 The Islands have developed considerable arsenals of legislation to combat financial crime and money laundering. They have generally followed UK models, sometimes in Jersey and Guernsey with a considerable time-lag. (14.4)

S154 The UK's arsenal includes legislation relating to fraud, theft, extradition, proceeds of drug-trafficking and terrorist crimes, all crimes money laundering, police and criminal evidence (PACE), and international co-operation. (14.5)

S155 The Islands now either have all these elements in place or will soon do so. The Isle of Man has all the main elements in place. (14.5)

S156 Jersey and Guernsey plan to enact their *All Crimes Money Laundering* legislation this autumn. They do not yet have PACE or *International Co-operation* Laws. In the absence of these, the authorities do not have powers to obtain information and evidence, or to assist overseas authorities, at the investigation stage, except in cases related to drugs, terrorism, insider dealing and serious or complex frauds. **They intend, however, to have these laws in place, including the secondary legislation, by the end of 1999. It is clearly important that they should do so.** Meanwhile they can assist in all cases where criminal proceedings have been instituted. (14.4 and 14.6)

S157 **For the most part, the Islands' existing and prospective legislation seems satisfactory.** In some respects, and especially in relation to fiscal offences, it seems to me better than that of most EU and FATF countries. (14.5)

S158 As in the UK, financial institutions and professionals in the Islands continue to have a common law duty of client confidentiality (though there are no banking secrecy laws). But the authorities have long had powers to override this duty in the pursuit of crime and the recent legislation has further enhanced their ability to do so. (14.4)

S159 The main problem areas have been:

- *Offences covered by the legislation*. The new all crimes money laundering legislation presently restricts co-operation with overseas authorities over searches, seizures and confiscation of assets to offences which, if committed locally, would be indictable or (in Jersey) have a maximum sentence of at least a year. These restrictions are included only in the all crimes money laundering legislation and not in the International Co-operation legislation covering other forms of assistance. For the reasons discussed in Chapter 14, they are not expected to impede co-operation in practice. (14.5 (a))

  **As a matter of principle, however, the legislation should not, in my opinion, include such limitations.** They give the wrong message to criminals and set a bad example to other jurisdictions, not least offshore jurisdictions. **If therefore the UK decides to drop any such limitation, I hope that the Island authorities will do likewise. For the sake of appearances, if nothing else, moreover, I hope that the Jersey authorities will either abolish the one-year maximum penalty criterion or reduce it to six months.** (14.5 (a))

- *Co-operation thresholds*. The fraud legislation in all the Islands, as in the UK, applies to cases of "serious or

complex" fraud. On this basis, the Jersey authorities have hitherto limited their co-operation with overseas authorities to cases involving 2 million or more, while sometimes being prepared to assist in smaller cases. The authorities have now, however, scrapped this threshold. **I am sure that they are right to have done so.** (14.5 (b))

- *Fiscal cases*. The Jersey authorities have also had a policy hitherto not to assist investigations by overseas authorities in purely fiscal cases. The authorities have now, however, dropped this restriction as well. **Here, too, I am sure that they are right to have done so.** I hope that the PACE and International Co-operation laws will likewise be designed to provide the necessary powers. (14.5 (c))

- *Consent requirements*. The new all crimes money laundering legislation in the Isle of Man and Jersey requires the Attorney General's consent before the police can disclose information obtained through the suspicion reporting system to people outside the Island. This requirement could in principle delay the transmission of urgent information. But the Attorney Generals in both Islands propose to solve the problem by issuing general consents. (14.5 (d))

- *Time-bars*. Jersey law requires that prosecutions of statutory offences must be brought within 3 years of the date when the alleged offences were committed. The Jersey authorities are recommending to their Parliament, rightly in my view, that all such time-bars to prosecution should be repealed. (14.5 (e))

S160 There are several areas, both in the UK and in the Islands, where the present legislation and international agreements might be improved so as to strengthen the hands of the authorities in the pursuit of financial crime and money laundering.

- *A general law on co-operation*. There may be a case for a single, general law on co-operation to replace the existing proliferation of differing provisions. Chapter 14 includes an illustrative sketch for such a law. **If the UK should think it right to adopt such a law, I hope that the Islands would consider following suit.** (14.7 (a))

- *Information "gateways"*. The UK and the Islands have similar "gateways" for individual authorities to exchange information in the pursuit of crime. The most important lacuna seems to be the inability of Tax authorities to supply information to other authorities in the pursuit of crime. **If the UK is able to introduce such a gateway, I hope that the Islands will follow suit.** (14.7 (b))

- *Jurisdiction issues*. With the increasing internationalisation of criminal activity, the problem of which country has jurisdiction has become more common. In too many cases, no country is willing to prosecute crimes that ought to be prosecuted. Neither the UK nor the Islands can solve these problems on their own. But **the Islands probably need legislation on the lines of the UK's Criminal Justice Act 1993, not yet implemented, to enable their Courts to hear cases where any element of an offence has been committed in the Island.** (14.7 (c))

- *Double Taxation Agreements (DTAs)*. The combating of tax evasion, now a major problem for virtually all jurisdictions, depends importantly on exchange of information between tax authorities. Double Taxation Agreements (DTAs) between the UK and each of the Islands provide for such exchanges. But these dated Agreements prevent information exchanged from being used in evidence. **They should preferably be replaced by either modern DTAs, based on the OECD model, or modern Exchange of Information Agreements (EIAs), with comprehensive coverage in each case.** (14.7 (d))

S161 The struggle against financial crime, including money laundering, is not yet being convincingly won anywhere. In the UK and the Islands, as in many other jurisdictions, such crime remains too profitable. There are various steps that the authorities could consider to take the profits out of crime. (14.8-14.9)

- *Unexplained life-styles*. There is a case for taking powers (as in the US and Ireland) to restrain assets, and reverse the burden of proof, in cases where people live beyond their visible means. **If the UK authorities should decide to take such powers I hope that the Island authorities will consider doing likewise.** (14.9 (a))

- *Penalties*. There is a case for much heavier financial penalties for financial crimes. The penalties in the Islands are mostly similar to, or in some cases higher than, in the UK. (14.9 (b))

- *Use of civil law and locus*. In both the UK and the Islands, prosecuting authorities could probably use civil powers more extensively to take the profits out of crime and recover proceeds. **Legislation can provide a clear locus for public bodies to use such procedures.** (14.9 (c))

- *Licensing and disqualifying the service providers*. The licensing and regulation of Trust and company service providers in the Islands, and enhanced regulation of lawyers and accountants, should make a substantial contribution to the prevention of financial crime. (14.9 (d))

*15 Financial crime and money laundering: practicalities*

S162 The overseas authorities whom I consulted told me that the Islands had been notably successful, and helpful, in the pursuit of drug trafficking and customs and excise offences, and not only in these areas. Where problems have arisen, they have mainly been in other areas. (15.1)

S163 The Island authorities have greatly improved their *intelligence* capabilities by introducing systems for *suspicious transaction reporting* along FATF and UK lines. In general these systems seem to work well. They have applied so far to suspicions of drug trafficking and terrorist offences. They have been or will soon be extended to cover suspicions of crimes of all kinds, including tax evasion and other tax offences, as set out in the new all crimes money laundering legislation. (15.2 and 15.2(c))

S164 The obligation to make suspicion reports rightly extends, as in the UK, to all categories of financial institution, bureaux de change, Trust companies, other companies, lawyers, accountants, investment advisers and other partnerships and individuals. (15.2(d))

S165 Even ahead of introduction of the All Crimes Money Laundering legislation, the *level* of suspicion reporting has been impressive. The Island authorities received 1670 suspicion reports in 1997. The majority of reports have come from banks, though life insurance and Trust companies too have made significant numbers. Other groups have made few reports. **The authorities need to ensure that reporting systems work properly in these groups.** (15.2(e))

S166 The Guernsey and Isle of Man authorities feed all their suspicion reports into the NCIS database in London. The Jersey authorities have in the past fed in only a limited number (where an initial check has proved positive) but propose to bring their practice into line with that of the other Islands. (15.2(g))

S167 The Islands' police authorities receive many more requests for help at the *investigation* stage than they make themselves. They believe that they provide a better service to others than others provide to them. There have been problems in certain areas but these seem well on the way to a solution where they have not been solved already. (15.4)

S168 The main problem has been that gaps in the legislative powers have hitherto hindered co-operation outside the areas of drug trafficking, terrorism, insider dealing and fraud offences. With the completion of the legislative arsenals, however, this will no longer be a problem in any of the Islands. As discussed above, the Isle of Man authorities have now effectively completed their legislative arsenal. The Jersey and Guernsey authorities will have completed theirs by the autumn of 1999. (15.4 (a))

S169 In Jersey, the authorities' policies (already mentioned) of not helping in fiscal cases and limiting assistance on fraud to cases above 2 million have further limited co-operation. These problems too, however, have now been solved. (15.4 (b))

S170 Some investigating authorities overseas whom I consulted seemed to believe, quite wrongly, that the Island authorities would not be willing to assist them. Others seemed to believe that requests for assistance from the Islands have to be routed through the Home Office or the FCO. **Their right course is to make contact directly with the Island authorities.** (15.4 (d) and (e))

S171 Some overseas authorities have urged that their own investigators be allowed, in appropriate cases, to join the local investigators in making searches and conducting interviews. **The Island authorities are all willing to do this.** (15.4 (f))

S172 For the most part, the Islands' procedures for obtaining *evidence* for overseas authorities have been less problematic. The traditional Letter of Request procedure seems to work well. Faster procedures are available in certain areas. (15.5)

S173 Some problems have arisen when witnesses are reluctant to swear *documents* for use as evidence in the Courts of other jurisdictions. The problem can, however, always be solved through the Letter of Request procedure, slow though this tends to be. (15.5 (b))

S174 The Tax authorities in all the Islands have no general powers to collect information for the benefit of tax authorities in other jurisdictions. But the Island authorities have powers and are willing to obtain evidence for use in criminal proceedings in *fiscal* cases in the same way as for other categories of offences. In the Isle of Man there are some restrictions on these powers. **The authorities may wish to consider whether these are justified.** (15.5 (a) and (c))

S175 The UK's *Extradition Act* 1989 applies directly to all three Islands. The Second Protocol to the European Convention on Extradition has not, however, been extended to the Islands. (15.6)

S176 When the new All Crimes Money Laundering legislation is in place, the authorities in all three Islands will be able and willing to *trace, restrain and confiscate* proceeds of crimes of all kinds, including tax evasion, in response to requests from overseas authorities, with the possible qualification mentioned earlier. The Isle of Man authorities have been able to do this since 1991. (15.7)

S177 Where necessary, civil procedures can be used as well. The Islands' Courts regularly issue Mareva restraint injunctions. (15.7)

S178 Where the Islands themselves are the lead-jurisdictions, they all have a policy to *prosecute* financial and other crime whenever there is sufficient evidence and a reasonable prospect of conviction. (15.8)

S179 The Island authorities have all made prosecutions relevant to the international finance centres over the years, though the numbers have been relatively small. Rates of conviction have been high. (15.8)

S180 The case which has attracted most attention in recent years is the Bank Cantrade case in Jersey (1998). Despite criticisms from the victims and their representatives, the authorities succeeded in obtaining two guilty verdicts and a partial guilty plea in a very complicated case. The authorities have noted for future reference the importance of bringing in specialist Counsel and forensic accountants from England at the earliest stage in cases of such size and complexity. (15.8)

S181 The Royal Court in Jersey has a policy to impose more severe sentences than in England. The Guernsey Courts have their own sentencing policy. The Isle of Man Courts follow English sentencing practice. (15.9)

*16 Financial crime and money laundering: resources and structures*

S182 The authorities in all the Islands are firmly committed to providing the *resources* of judiciary, prosecution, law enforcement and intelligence necessary to police their international finance centres effectively. (16.1)

S183 **Some increases in professional staff are clearly needed in certain areas.** (16.2)

S184 My impression is that the Island *Judiciaries* have been and remain well able to cope with the considerable workloads associated with the international finance centres. QCs are brought in from the UK to help in case of need. (16.2)

S185 The *Law Officers* bear heavy burdens in all the Islands. The Guernsey authorities plan to take on two or three extra staff. The Jersey and Isle of Man authorities, too, are reviewing their needs. (16.2)

S186 In the *police* and *Customs* areas, the allocation of resources to fraud and commercial work, financial intelligence, investigations and responses to requests from other jurisdictions is of particular concern. Jersey now employs 11 people in these areas; Guernsey employs 8; the Isle of Man employs 6.5. (16.3)

S187 All the Islands will need extra resources to deal with the expected increase in suspicious transaction reports and confiscation orders after the new all crimes legislation and suspicion reporting take effect. (16.3)

S188 Jersey and Guernsey have provisionally estimated that they will need 2 extra staff for this purpose. They may need one or two more staff in related areas as well. (16.3)

S189 The Isle of Man appears to have a special need for extra staff in this area. Around 4 extra staff seem to be needed, in addition to filling the present vacancy and an extra 2 staff for the all crimes suspicion reporting. The Head of the Fraud

Squad should preferably have no other responsibilities. (16.3)

S190 **In my opinion, the Islands would do well to consider new structures as well for policing their finance centres.** (16.4)

S191 The present Fraud Units and Joint Financial Investigation and Intelligence Units could be brought together into single, self-standing, multidisciplinary *Financial Crime Units (FCUs)*. These units would be responsible for policing the Islands' finance centres and supporting the Attorney Generals in their roles as public prosecutors for the finance centres. The Director could report to the Attorney General, with dotted reporting lines to the Chief Constable and the Treasury or equivalent Committee. (16.4)

S192 The Units would be financed separately from the Police and Customs. The Attorney Generals would be responsible for ensuring adequate budgets for policing and investigation of the finance centres. (16.4)

S193 The Units would work in close co-operation with the Attorney General's office, the Police, Customs, the Tax departments and the financial regulators but be separate from them. Staff would be able to make careers in this specialist area of work. They would no longer be obliged to move back and forth between this and other policing work. (16.4)

S194 The suggested structure would differ from present UK structures. But the Islands, being small, have options that the UK does not have. In the opinion of many of the professionals I consulted, moreover, the UK too needs a National Fraud Squad. (16.5)

*17 International standards*

S195 The authorities in all the Islands accept that international standards of regulation, policing and co-operation are an absolute obligation. (17.1)

S196 They accept that high standards will drive away some categories of business, not necessarily confined to disreputable business, as well as attracting others. (17.2)

S197 **They have been concerned, rightly in my opinion, to obtain due recognition for high standards.** (17.3)

S198 They have therefore sought to encourage the development of *accreditation* or other forms of recognition from international bodies such as the FATF, the Basle Committee, IOSCO and IAIS. In this there has been some good progress, though less than might have been hoped. (17.3)

S199 In some areas, such as Trusts, there are no international bodies or forums that set and monitor standards. **The UK would be well placed to promote** establishment of an international forum on Trusts. (17.3)

S200 The Islands have also sought to obtain *favourable treatment* from the larger countries individually in recognition of their regulatory standards. Examples are designated territory status in insurance and investment. There is scope for the larger countries to extend such practices, in return for high standards of regulation and co-operation, especially in the fields of market access and tax enforcement. (17.4)

S201 The Islands have taken a leading role in seeking *to promote high standards in the offshore generally*. The Jersey authorities have been instrumental in developing the role of the Offshore Group of Banking Supervisors (OGBS) and in developing the Group's involvement in the FATF processes. The Guernsey authorities have been similarly active since 1993 in developing the Offshore Group of Insurance Supervisors, OGIS. (17.5)

S202 **There may be a case for replacing or supplementing the OGBS with a new structure comprising an Offshore Steering Group (OSG) at senior level, with a paid working Chairman and sub-committees for individual areas of regulation or policing.** (17.5)

S203 Also useful might be a forum for periodic discussions between representatives of the OSG and onshore jurisdictions including countries associated with offshore centres and other interested countries and international financial bodies. **The UK might be well-placed to convene such a forum.** (17.5)

S204 If no progress can be made in these areas, the UK, the Crown Dependencies and the British Overseas Territories could consider setting up a small independent *Financial Centres Audit Office (FCAO)*. Such a body might help the offshore centres associated with the UK to achieve high standards, a level playing field and an enhanced reputation compared with other offshore centres. The better course, however, would be to develop international co-operation, accreditation and recognition. (17.6)

*18 Conclusion*

S205 For the most part, the infrastructures the Islands have developed for their international finance centres seem remarkably good for such small jurisdictions. (18.1.2)

S206 The Island authorities are all committed to implement the All Crimes Money Laundering regimes, to extend the regulatory boundary to encompass Trust and Company service providers, and to ensure adequate resourcing of the regulation and policing of their finance centres. (18.1.3)

S207 The authorities would all do well to consider the case for a financial services ombudsman and the points on Trust law discussed in Chapter 12. (18.1.4)

S208 In other areas, the **requirements and priorities** vary from Island to Island.

- In *Jersey*, the authorities' most urgent requirement, in my opinion, is to reach a position where they can and do co-operate fully with other countries in the combating of crime of all kinds, including tax evasion and lesser frauds as well as money laundering. This will require early passage of the missing elements in the legislative arsenal as well as the welcome changes in policy stance already made. Financial and company regulation needs to be developed and deepened in certain areas. Customer protection schemes need to be considered. Companies operating but not incorporated in the Island need to be registered.

- In *Guernsey*, the urgent requirements, which the authorities are already tackling, are the proposed legislation to deal with the problem of "nominee" Directors and completion (as in Jersey) of the legislative arsenal to combat financial crime and money laundering. The Law Officers need more staff. As in Jersey, companies operating but not incorporated in the Island need to be registered. The insolvency legislation needs to be updated. Certain aspects of financial regulation need to be developed. Customer protection schemes need to be considered.

- In the *Isle of Man*, the urgent requirement is to strengthen regulation of the Island's large company sector and its considerable population of company and Trust service providers. New insolvency legislation is needed. Certain aspects of financial regulation need to be developed and extra resources are needed in several areas. The police need more resources to combat fraud and money laundering. (18.1.5)

S209 The Report has identified **suggested needs for around 20 extra professional staff in each Island** to police and regulate the international finance centres (see Box 18.1). It may be possible to meet some of the requirements by redeployments from elsewhere. (18.3)

S210 Chapter 18 includes a **list of principal measures discussed in the Report** (see Box 18.2). Some are the Islands' own proposals. Others are suggestions which I hope the Island authorities will consider. (18.4)

S211 I hope that by the spring of 2000 the Island authorities will either have implemented or be well on the way to implementing all the proposals discussed or will have decided what alternative courses to pursue. (18.4)

### 2.13 Vulnerabilities

2.13.1 The potential risks to the Islands' finance centres are the same as for other such centres. They come partly from outside and partly from inside.

2.13.2 From outside, the main risk is that the large countries where most of the Islands' customers live or conduct business will change their tax laws, regulations or enforcement practices in ways which might make the facilities of offshore centres seem less attractive. The large countries might seek to introduce new international tax standards or conventions: the on-going discussions in the G7, the OECD and the EU are addressing these matters. Or they might individually make further changes in their tax regimes, as they have done in the past. Or they might sharpen their enforcement practices. It seems likely, however, that such measures would lead to changes in the mix of business of offshore centres rather than put them out of business altogether.

2.13.3 Re-introduction of exchange controls could likewise have major effects on offshore centres. Such a development, however, looks improbable.

2.13.4 Regulatory policies, attitudes and standards in the larger countries, including conditions for marketing financial services there, could have some impact as well.

2.13.5 From inside, the main risk is a loss of reputation. Offshore finance centres, even more than the large onshore centres, live by their reputations. Their problems, real or perceived, tend to receive disproportionate coverage in the world's Press.

2.13.6 The reputations of any finance centre may suffer as a result either of genuine problems or of misinterpretations. Genuine problems may include corruption, crime or perceived failures of legal processes or regulation, and the associated public scandals. The laws, regulations and systems discussed in this report are largely concerned with minimising the likelihood of such problems.

2.13.7 Also important are perceptions of confidentiality. As with other finance centres, some customers with entirely legitimate business would move their business elsewhere if they felt that their affairs would not remain confidential.

2.13.8 Misinterpretations may be troublesome as well. All too often the successes of offshore centres, notably in the fight against international crime and money-laundering, are misinterpreted as indicating a prevalence of criminal activity rather than effective counter-crime systems.

2.13.9 Among other internal risks, two are especially worthy of mention. As discussed above, the Islands could have difficulty in providing skilled staff and professional and support services to sustain ever-increasing amounts of business. They could also lose much of their comparative advantage, compared with the large countries, if local wage costs should ever become significantly uncompetitive.

### 2.14 Criticisms and defences of offshore finance centres

2.14.1 Offshore finance centres as a group have attracted considerable criticism in recent years. It is sometimes argued, especially in the large jurisdictions, that they serve no useful purpose and should not exist at all. The centres themselves argue, on the contrary, that they contribute significantly and constructively to the world's financial system.

2.14.2 The critics usually target three main features of the centres:

- the *tax regimes*, which are often seen as inducing particular industries to choose unsuitable offshore locations at the expense of the onshore jurisdictions and as depriving onshore jurisdictions of tax revenues properly due to them;

- a framework of *secrecy, allied to poor co-operation* with other countries, which attracts and facilitates disreputable

business and money laundering; and

- poor *regulation*, which enables financial institutions to build businesses on the back of low standards, with considerable risks to clients.

2.14.3 Later chapters of the report suggest that the second and third criticisms, if applied to the Crown Dependencies, would be quite wide of the mark. For the most part, the position in these Islands is quite the opposite of what such criticisms would imply.

2.14.4 The report does not offer any assessment of the Islands' tax regimes. The tax regimes of offshore centres generally, and indeed of onshore centres, are the subject of on-going discussion in the G7, the OECD and the EU. The offshore centres themselves argue that onshore centres, too, are active in seeking to attract business through favourable tax regimes.

2.14.5 The case in favour of offshore finance centres, from a global perspective, includes a number of elements:

- *The right to supply services*. There are many quality services to customers that well-regulated offshore centres are well able to supply and have a perfect right to supply like anyone else. Examples are Trust services and services to expatriates.

- *Stability*. Stability is an advantage that offshore centres may be able to offer. In the Crown Dependencies, systems of Government have remained remarkably stable over many centuries. Rates of tax on personal and corporate incomes have remained unchanged, at 20 per cent, for many years.

- *Risk spreading*. International clients wishing to spread their risks may find it helpful to spread their assets between different jurisdictions.

- *Convenience and simplicity*. Especially in an electronic age, the offshore centres are well placed to facilitate business or co-ordinate transactions involving many different jurisdictions through provision of a base free from the tax and other complications of the larger jurisdictions. In this way they may help to lubricate the world's financial markets. Examples are international custody or treasury operations and banking services.

- *Innovation and flexibility*. The offshore centres are sometimes better able than the larger centres to test out innovative financial products such as new insurance or investment vehicles. They can respond flexibly and quickly to the changing needs of international customers and markets. In the larger centres, the ramifications of change are typically wider.

- *Regulation*. The offshore centres may also be able to lead the way in certain areas of regulation. Examples are the regulation of Trust and Company services providers, discussed in chapter 13 of the Report.

- *Fiscal elements*. A degree of competition in tax rates may be helpful, not least in giving the large countries an added incentive to avoid penal rates of tax.

**BOX 2.1-Selected Offshore Finance Centres**

*Selected data, for latest available period*

| | *Jersey* | *Guernsey* | *Isle of Man* | *Gibraltar* | *Bermuda* | *Cayman* | *British Virgin Islands* | *Hong Kong* | *Singapore* |
|---|---|---|---|---|---|---|---|---|---|
| Population, '000 | 85.2 | 61.4 | 71.7 | 27.2 | 61.5 | 35 | 19.1 | 6,617.1 | 3,103.5 |
| Population density, persons per square mile | 1,898 | 2,040 | 316 | 11,738 | 2,934 | 178 | 321 | 14,970 | 12,414 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| GDP per head, | 15,854 | 15,615 | 8,931 | 11,623 | 22,024 | 18,609 | 14,940 | 16,743 | 15,683 |
| Bank deposits, bn | 99.8 | 49.8 | 20.0 | 2.9 | 8.94 | 303 | 5 | 211.5 | 114.5 |
| Of which: | | | | | | | | | |
| Sterling, bn | 32 | 17.8 | 13.7 | na | na | na | na | na | na |
| Dollars, $ bn | 61.9 | 22.4 | na | na | 12.45 | na | na | na | na |
| Funds under management, bn | 37.8 | 16.7 | 7.5 | 4 | 12.1 | 118 | 33 | 488 | 45 |
| Insurance assets held, bn | 0.4 | 7.4 | 12.3 | 0.1 | 60.18 | 5.9 | na | na | na |
| Annual premium income, m | 23 | 2,139 | 3,100 | 43 | na | na | na | na | 1,497 |
| Companies locally incorporated, '000 | 32 | 16 | 42 | 25 | 12.8 | 47 | 302.3 | 477 | na |
| Of which: | | | | | | | | | |
| Normal Tax | 16 | 8 | 20 | na | 2.3 | na | 1.4 | na | na |
| Special tax or no tax | 16 | 8 | 22 | na | 10.5 | na | 300.9 | na | na |

**BOX 2.2-Parentage of the Islands' Financial Institutions**

*Percent of total institutions, end-1997*

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| Banks etc | | | |
| UK | 44 | 40 | 63.1 |
| Other EU | 20 | 25 | 15.4 |
| Other Europe | 8 | 16 | 1.5 |
| N America | 15 | 9 | 3.1 |
| South Africa | 4 | 3 | 4.6 |
| Other overseas | 9 | 7 | 6.2 |
| Local | | | 3.1 |
| Liquidators | | | 3.1 |
| Investment institutions | | | |
| UK | 30 | 31 | 20.5 |
| Other EU | 12.5 | 21 | 10.3 |

| | | | |
|---|---|---|---|
| Other Europe | 9.5 | 9 | 6.4 |
| N America | 12.5 | 12 | 3.8 |
| South Africa | 8.0 | 9 | 7.1 |
| Other overseas | 12.5 | 10 | 6.4 |
| Local | 15.0 | 8 | 45.5 |
| Insurance companies | | | |
| UK | 21 | 77 | 75 |
| Other EU | 14 | 10 | 6.0 |
| Other Europe | 7 | | 2.2 |
| N America | 30 | 3 | 3.8 |
| South Africa | 21 | 4 | 5.0 |
| Other overseas | | 6 | 7.5 |
| Local | 7 | | 0.5 |

**BOX 2.3-Customers of the Islands' Financial Businesses**

*Percentages of total business originating from the areas listed or denominated in the currencies listed. Based on latest available data.*

| | Jersey | | Guernsey | Isle of Man |
|---|---|---|---|---|
| *Bank deposits* | *June '96* | *June '98* | | |
| UK | 15 | 19.4 | 16.3 | 29.4 |
| Other EU | 8 | 7.6 | | 13.3 |
| Other Europe | 32 | 32.1 | | 10.8 |
| N America | 4 | 4.1 | 62.8 | 4.2 |
| Other overseas | 26 | 22.3 | | 13.9 |
| Local | 15 | 14.5 | 17.7 | 28.4 |
| Other CDs | | | 3.2 | |
| UK £ | 32 | 37.9 | 33.8 | 69.2 |
| US $ | 42 | | 45.5 | |
| DM | 7.5 | | 10.7 | |
| FF | 0.7 | 62.1 | 1.1 | 30.8 |
| Other European | 6.2 | | 4.9 | |
| Yen | 0.3 | | 0.4 | |
| Other | 11.3 | | 3.6 | |
| *Funds under management (based on currency denomination)* | | | | |
| UK | | | | 31.2 |
| Other EU | | | | 1.8 |
| Other Europe | na | | na | |
| N America | | | | 79.7 |
| South Africa | | | | |
| Other overseas | | | | |
| Local | | | | 5.3 |
| *Insurance premium income* | | | | |
| UK | 10.5 | | 56.8 | |
| Other EU | 3 | | 23.4 | |
| Other Europe | 3.3 | | — | |
| N America | 17.2 | | 2.2 | na |
| South Africa | 56 | | 13.2 | |
| Other overseas | — | | 4.4 | |
| Local | 10 | | — | |

**BOX 2.4-Numbers Employed in the Finance Sectors**

*Full and part time, latest available dates*

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| Banks and other deposit takers | 4,700 | 2,700 | 1,781 |
| Investment and securities business | 1,500 | 1,394 | 1,229 |
| Insurance and pensions | 1,400 | 720 | 1,657 |
| Company, Trust and Advisory services | | 1,252 | 739 |
| TOTAL | 7,600* | 6,066 | 5,406 |

*Note:*
*Jersey and Isle of Man figures exclude, but Guernsey figures include, lawyers working in legal firms and accountants working in accounting firms.*

### 6.10 Coverage of regulation

6.10.1 In all three Islands, the regulator bodies cover the supervision of banking, investment and securities and insurance business. The Jersey authorities are in the process of extending regulation to cover investment business generally as well as collective investment schemes. The Isle of Man authorities have covered such business for some years and the Guernsey authorities have recently brought it within the regulatory boundary.

6.10.2 The regulatory bodies are also responsible for ensuring that institutions throughout the financial sector have good systems and practices for countering money laundering.

6.10.3 The coverage of companies supervision varies between the Islands. In my opinion, for the reasons discussed in Chapter 10, full coverage of the Islands' company sectors is a key element in the total task of financial regulation. For the reasons discussed earlier in this Chapter, moreover, the Islands' FSCs are best placed to carry out such supervision alongside the other elements in financial regulation.

6.10.4 All three Islands have plans to extend the regulatory boundary to include providers of corporate services (including company formations and Director and management services) and Trust companies (or Trust service providers). When this has been achieved, regulation will extend to all categories of financial services for international customers other than some of the professional services.

6.10.5 For reasons discussed in later Chapters, I believe that the Islands are right to have policies to extend the regulatory boundary in this way, despite the considerable resource implications.

### 6.11 Depth of regulation

6.11.1 Another strategic issue is the depth of regulation. This is relevant both to existing areas of regulation and to the new areas now proposed. It is an issue not just for the Island authorities but for the authorities in all finance centres.

6.11.2 If the major objectives of regulation are to include protection of customers, orderly markets and combating of crime, the regulatory authorities need to combine the traditional emphasis of regulation on issues of overall solvency and liquidity with new emphases on:

> management and control systems, staff quality and competence, evaluation of market risk, systems for countering fraud, money laundering and other crime, and conduct of business.

6.11.3 There is, I believe, a growing consensus that regulation must play a part in these as well as the more traditional areas. These are the main areas where problems have occurred in recent years in financial institutions across the world.

6.11.4 The authorities in all the Islands, especially Guernsey perhaps but also the Isle of Man and Jersey, have taken significant steps in this direction. But there would in my view be advantage in drawing up principles, rules or codes of conduct, as appropriate, to cover each of these areas, where they do not exist already, and in extending those that already exist where necessary. There are many models, in the UK and elsewhere, on which to draw.

6.11.5 These matters should also increasingly form part of the standard agenda of supervision, including on-site inspection.

### 6.12 Prosecution powers

6.12.1 There is an issue whether the FSCs should also be prosecuting authorities in relation to a defined list of criminal offences, such as the unauthorised soliciting or taking of deposits or currency offences.

6.12.2 In the UK, the Bank of England had such powers and the FSA will have more. The Isle of Man FSC likewise has some prosecution powers.

6.12.3 In my opinion, there are considerable advantages in the FSCs having prosecution powers alongside their enforcement powers. But there is no absolute requirement. The essential requirements are:

- effective civil enforcement powers, to support a policy of active enforcement, and
- good links between the FSCs and the prosecuting and law enforcement authorities, including appropriate information "gateways".

6.12.3 If the FSCs have *no* prosecution powers, such links are all the more essential.

### 6.13 Fines and naming

6.13.1 With limited exceptions, the Islands' regulatory bodies do not have powers to impose fines or penalties. In all the Islands, however, the Courts can impose fines for breaches of regulatory laws. There are fixed penalties for late filing of information by companies.

6.13.2 The Island authorities will however be considering present practices in the light of the recent proposals that the FSA in the UK should have more extended powers to fine.

6.13.3 In certain areas, the FSCs have powers to "name and shame" offending firms or institutions. In my opinion such powers, sparingly used, are an important weapon in the armoury of regulators and should preferably be available in all sectors of regulation. Powers to impose penalties are, in my opinion, a valuable but not essential adjunct to such powers.

### 6.14 International co-operation

6.14.1 The Islands' FSCs generally have a good reputation for co-operating with regulatory authorities overseas.

6.14.2 The *Guernsey* regulators have made a special point of good co-operation and have least impediments in doing so. FSC staff are able to share information in the pursuit of regulatory offences and breaches within a general requirement of confidentiality of information from which individuals or bodies can be identified. Confidential information of this kind can be passed to any overseas regulator:

- in the public interest,
- in the interests of detection or prevention of crime, and
- in compliance with a direction by the Royal Court.#

There is no specific requirement for approval before information can be passed nor any special protection for customers.

6.14.3 The *Isle of Man's* FSC, too, has made a special point of good co-operation with regulators outside the Island, both proactive and reactive. The Isle of Man's special enforcement unit has played a key role in this.

6.14.4 The FSC's powers are similar to those in the UK. The Island's Financial Supervision Act 1988 empowers FSC staff to share information provided that this is in the public interest and the information will be of value to the recipient. A recent addition to the Island's legislation allows the FSC to exercise its investigative powers where appropriate at the request of a foreign regulatory body.

6.14.5 The main difference, compared with the UK, is that the Chief Minister's approval is required for giving of information relating to the affairs of a client. I am not aware that this requirement has caused problems in practice. But it seems unnecessary as well as a potential source of delay. Clients may include large institutions regulated by other authorities. I hope that the authorities will consider whether this requirement needs to be retained.

6.14.6 The *Jersey* authorities have adopted an even more cautious approach. The FSC will have mutual assistance powers under the new Investment Business Law to make inspections and investigations so as to assist overseas regulators. But the new provisions do not allow FSC staff to pass to overseas regulators information relating to the identity of customers or others who have done business with a registered person. As discussed above, such customers may include institutions regulated by an overseas authority as well as individuals. There is, moreover, no provision for overriding this prohibition.

6.14.7 In certain cases, the police might be able to investigate. But this will not be a solution if the overseas regulators need help, as they may well do, on important regulatory issues not necessarily involving criminal behaviour, such as the nature and extent of the exposures, pattern of trading transactions through Jersey firms, or customer base of such a customer.

6.14.8 I hope that the Jersey authorities will be willing to remove this prohibition.

6.14.9 The legislation in all the Islands provides a general immunity for FSC staff from civil suits, where they have acted fairly (or not in bad faith) in the exercise of their functions.

6.14.10 The Jersey and Guernsey legislation also includes a provision borrowed from UK legislation, now amended in the investment business area, making breach of the statutory confidentiality provisions a strict liability criminal offence.

6.14.11 This seems to me excessive. It sends the wrong signal about international co-operation both to staff and to the rest of the world. It would better be amended (as the UK and the Isle of Man have done in the area of investment business) to provide for a defence of due diligence.

### 6.15 Customer protection against business failures

6.15.1 Customer protection schemes, designed to give some protection to depositors, investors and policyholders if the banking, investment or insurance company concerned should collapse, are another element in the coverage of regulatory authorities in many of the larger countries. Such schemes are mostly funded by the industry itself on a "pay as you go" basis.

6.15.2 In the UK, the maximum individual payouts under these schemes are presently as follows:

- Bank and building society depositors: 18,000 (90% of the first 20,000 of loss)
- Qualifying investment schemes: 48,000 (100% of the first 30,00 plus 90% of the next 20,000)
- Insurance claims: no maximum limit but payment is mostly limited to 90%, with 100% payments reserved for specified compulsory insurance policies.

6.15.3 The FSA in the UK has published proposals to rationalise the present schemes and to gear them towards customers least able to sustain losses, notably individuals and smaller firms. The aim is to do this without removing the incentive to customers to choose carefully the institutions with which they do business. It is proposed that the new schemes should all be on a "pay as you go" basis.

6.15.4 EU Directives will shortly oblige member states to introduce protection schemes with upper limits of at least 20,000 ecu for investors as well as depositors. The EU does not at present have similar requirements on insurance.

6.15.5 The Isle of Man is the only one of the Islands that presently has a full range of customer protection schemes in place. The Island authorities introduced these schemes in order to restore confidence after the Savings and Investment Bank collapse in 1982 and to establish standards similar to those of the UK. The schemes are similar, though not identical, to those in the UK. Under the depositor protection scheme, activated after the BCCI collapse, the maximum individual payout is 15,000 (75 per cent of the first 20,000). Under the investment protection scheme, the maximum payout is 30,000.

6.15.6 Jersey and Guernsey have schemes on UK lines in place for "recognised" collective investment schemes (which qualify to be approved for marketing to the general public in the UK) but not for depositors or policyholders. UK policyholder protection may, however, protect certain policyholders of Island branches of UK firms in certain circumstances.

6.15.7 For any financial centre committed to protecting consumers of financial services, the question whether to have such schemes is one that needs to be considered. Gibraltar is in the process of introducing depositor and investor protection

schemes, in conformity with the EU Directives. In the Caribbean, such schemes exist but the benefits are usually confined to local people who belong to the islands and make use of local banks and insurance companies.

6.15.8 The arguments in favour of having such schemes, for international as well as domestic customers, are that they significantly enhance customer protection, especially for small customers, and have now become a standard feature of the European onshore scene. Once established, they are not, of course, expensive for financial services authorities to administer unless and until an institution does collapse. If that does happen, the existence of the schemes is likely to be a great benefit.

6.15.9 The justification usually advanced for doing without such schemes is that many of the customers of offshore centres are wealthy people and businesses for whom the maximum payment limits in such schemes would be drops in the ocean. There will, however, be many other, less wealthy, customers where this is not so.

6.15.10 A further consideration is that the scheme needs to be able to cover a major collapse within a reasonable time-frame. The contingent liabilities for Island institutions may therefore be considerable.

6.15.11 The conclusion I would draw is that, for any finance centre, such schemes are good practice. They may not yet be quite essential. But their adoption throughout the EU countries strengthens the case for having them in all the Islands.

### 6.16 Customer disputes procedures

6.16.1 The problems which customers of finance centres may have are not limited to cases where the institution or firm concerned has collapsed. The problems are at least as likely, and indeed more likely, to arise in relation to institutions or firms which remain in business. In such cases, customer protection and compensation schemes along the lines described in the previous section are not, of course, relevant.

6.16.2 The FSCs in all the Islands have procedures for handling customer complaints. In all cases, they refer the complaint to the firm or institution concerned. Sometimes there is discussion as well. In Jersey, the FSC offers a complaint conciliation service which has proved quite successful.

6.16.3 For the most part, however, the FSCs' practice is not to intervene between institutions and their customers. Their principal concern is to consider any wider implications for the systems and practices of the institution or firm concerned.

6.16.4 The Islands, like other offshore centres, do not at present have independent "Ombudsman" systems either, for considering customer complaints and resolving disputes. The one exception to this is that the Isle of Man authorities have appointed the UK Pensions Ombudsman to act in relation to occupational pensions in the Isle of Man as well.

6.16.5 Several customers of the Islands, both resident and non-resident, wrote to me about disputes they were having or had had with Island institutions and firms. I have no reason to suppose that such disputes are either more or less common in the Islands than in other finance centres. If I had invited the customers of other centres to write to me, I would probably have received similar responses.

6.16.6 As discussed in an earlier Chapter, I have not sought to judge the rights and wrongs of individual cases. But I was struck by the amount of unhappiness generated. Many of the aggrieved parties argued that they had no effective means of redress. The local Financial Services Commissions were seen as being unwilling to help. Although some legal aid is available in all the Islands to residents and non-residents, the legal processes were seen as too long and too expensive, the likely outcomes as too uncertain. Some of my correspondents seemed to have devoted large parts of their lives to correspondence with the institutions and firms concerned, with legal advisers, with the local Financial Services Commissions and with the relevant Parliamentary Committee or Government Department. In some instances, they had also made great efforts to generate publicity for their cases.

6.16.7 In my opinion, the Islands would be well advised to consider establishing an independent Financial Services Ombudsman to help resolve such disputes, even though other offshore centres do not as yet have anything comparable.

6.16.8 Potentially at least, there would be advantages for complaining customers, institutions complained against and regulators alike:

- Aggrieved customers would be likely to welcome the opportunity to ask a visibly impartial tribunal to examine their

cases, and to make or recommend awards, without incurring massive legal fees. Early resolution, even if the complaint is not sustained, may save years of misery.

- For the institutions concerned, a framework for speedy resolution of disputes by an impartial tribunal should likewise be attractive.

- For the Financial Services Commissions, too, there must be attractions in being able to advise complainants to take their complaints to an independent Ombudsman. The appearance of unwillingness to help is an embarrassment for any organisation with responsibilities for customer protection.

6.16.9 A further advantage that Ombudsmen have is that they can take a broader view of what is reasonable, less constrained by the letter of the law, than the Courts are able to do.

6.16.10 The Guernsey FSC showed me some interesting proposals they have worked up for a Financial Services Ombudsman. Under these, the Ombudsman would Chair a panel of 12 people (many of them probably retired). For individual cases, the Ombudsman or his alternate would sit with two people of appropriate experience drawn from the panel. Professional help would be commissioned from the FSC or private sector experts as appropriate. The authorities estimated that costs might be around 10,000 in the first year but less thereafter. This may however be optimistic.

6.16.11 The Jersey authorities, too, have looked at the possibility of an Ombudsman scheme.

6.16.12 There are a number of other critical issues that would need to be considered in relation to the establishment of an Ombudsman. The recent consultative paper by the UK's Financial Services Authority, *Consumer Complaints*, discusses these.

6.16.13 For the Island finance centres, I would see a number of presumptions, as follows:

- The Ombudsman scheme should apply to *all* financial institutions and service providers and should be industry-wide, not voluntary.

- Customers eligible to complain to the Ombudsmen should be private individuals, unincorporated bodies, partnerships and small companies, resident or non-resident, who are or have been customers of the firm or institution complained against.

- There should preferably be no inflexible published limit on the maximum amounts involved in cases which the Ombudsmen may consider.

- Customer complaints should be made direct to the Ombudsmen. The Ombudsmen themselves, not the FSCs, should filter out cases which should not have been referred to them. They should have powers to exclude complex cases requiring judicial processes and frivolous or vexatious cases.

- For cases not sifted out, the Ombudsmen's first stage should be conciliation. In the UK, around 80 per cent of cases are resolved at this stage. The next stage should be an informal or recommended award. In the UK, 15 per cent of cases are resolved at this stage.

- For cases not so resolved, there is an issue whether the Ombudsmen themselves should then make binding awards (and enforce them as required) or whether it should be for the Courts at that stage to determine whether the recommended awards are fair and reasonable, and to enforce them if so.

- The Ombudsmen should be accountable to the Island Parliaments, and should submit published annual reports to them.

- The Ombudsmen should be obliged to consult the Financial Services Commissions about standards of business behaviour to be expected in regulated bodies and to feed back case-information to the Regulators so that the Regulators may draw any necessary conclusions for regulatory systems generally.

6.16.14 The main obstacle, perhaps, to establishment of an Ombudsman system is cost. But the cost is likely to be small in relation to the benefits. Costs might be reduced, moreover, if the three Islands, or Jersey and Guernsey at least, were to

establish a *joint* Ombudsman.

### 6.17 Finance centre staff training

6.17.1 The Islands' finance industries depend heavily on well-trained local staff as well as staff from outside. In each of the Islands, therefore, the authorities have been active in providing local education and training programmes at various levels designed for finance sector staff.

6.17.2 The Jersey authorities have recently brought together previous bodies into a new Business School, which offers MBA and BSc programmes in financial services in association with UMIST and the Chartered Institute of Bankers as well as more basic training courses.

6.17.3 The Guernsey FSC oversees finance sector staff training through an associated organ, the Finance Training Agency Limited. The Agency facilitates course provision and provides services and support for the student body.

6.17.4 In the Isle of Man, the FSC supports education and training programmes provided by the Island's College of Further Education in association with Liverpool University, the Chartered Institute of Bankers and the Securities Institute.

**BOX 6.1-Financial and Company Regulation in the Islands: Resources**

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| *Regulatory Staff, August 1998 (full-time equivalents)* | | | |
| Director General* | 1 | 1 | 1 |
| Banking | 5 | 4 | 3.5 |
| Investment business: | | | |
| (a) Collective investment schemes | 10 | 7 | 2.5 |
| (b) Other | 4 | 2 | 2 |
| Insurance | 1.5 | 8 | 4 |
| Trust and Company service providers | | | |
| Company registration & supervision** | 7.5 | 5 | 20.5 |
| Enforcement | Included above | 1 | 3 |
| Central policy & operations | Included above | 2 | 8.5 |
| Support staff*** | 10 | 11 | 8 |
| TOTAL | 39 | 41 | 53 |
| *Licence and registration fee income,1997-98, million* | 6.9 | 2.2 | 5**** |
| *Expenditure, 1997-98, million* | 2.0 | 2.4 | 4 |
| *Fee income as % of expenditure* | 345% | 92% | 125% |

NOTES

* The Director of the IoM's IPA is scored in the Insurance row.

** Includes company registries staff as well as staff in the FSCs who work on companies.

*** Support staff include those responsible for accounts, technical services, secretaries, clerical & reception staff. Other staff numbers relate to professional supervisory staff.

**** Excludes non-resident company duty of 6 million.

### 9.9 Protected Cell Companies

9.9.1 The Guernsey authorities introduced legislation in 1997 for Protected Cell Companies (PCCs). This is a new form of company vehicle designed to make the advantages of captive insurance available to smaller companies by reducing costs and to provide analogous benefits for investment funds. For convenience we discuss this legislation in the present Chapter only and not in the Investment Business Chapter as well.

9.9.2 Australia, Bermuda and the Cayman Islands have different types of PCC legislation in place. The Jersey and Isle of Man authorities have decided against introducing such legislation, for the time being at least.

9.9.3 The basic idea is that the PCC's sponsor, instead of setting up separate captive company vehicles for the businesses of each insured entity, sets up a single company vehicle and writes the various businesses into separate cells within the single vehicle. There is in principle, therefore, one set of legal expenses and one capital requirement, shared between the insured entities taking part, instead of multiple legal expenses and capital requirements. The insured entities rent space in a common, partitioned vehicle and thus avoid having to set up their own separate vehicles. But the assets of one cell are protected by law from the liabilities of another.

9.9.4 The protected cell structure can in principle offer similar economies for investment funds. Guernsey now has 9 Protected Cell Companies for insurance and 11 for investment funds.

9.9.5 A critical question, which has prompted considerable debate, is whether the protection of the cells would stand up in the event of legal challenge. If one of the cells became insolvent, and the PCC's common capital was insufficient to pay the debts, the liquidator or others would doubtless seek to realise assets from the other cells to pay the creditors. Depending on the scale of the debts, the other cells too could be put at risk.

9.9.6 In the view of the lawyers I have consulted, Courts in all the major jurisdictions would consider ineffective protected cell structures established by means of contracts within an ordinary company (that is, not within a PCC). Such contracts would be seen as an attempt to put shareholders above creditors. The other cells would be deemed liable, pari passu, if the company's capital was insufficient.

9.9.7 The question, therefore, is whether the Guernsey law would give the other cells protection where a contractual agreement would not.

9.9.8 If the case were heard in Guernsey and the assets were in Guernsey, the structure would doubtless be effective.

9.9.9 As the Guernsey authorities themselves have been the first to acknowledge, however, there is no knowing whether Courts in other jurisdictions would accept the structure or set it aside, especially in cases concerning PCC debts and assets in other jurisdictions.

9.9.10 This issue arose soon after the original legislation was introduced. After consultation with a leading UK QC, therefore, the Guernsey authorities have amended the legislation to make clear that the provisions as to limitation of liability are, under the rules of international law, substantive and not merely procedural. The authorities believe that the legislation, as amended, will be effective in protecting the assets of individual cells from the liabilities of other cells.

9.9.11 The uncertainty over how overseas Courts would regard the legislation is clearly a factor which any potential participant in a protected cell structure needs to weigh carefully. The Guernsey authorities have rightly, therefore, been scrupulous in making clear that the legislation has not been tested in the Courts. They should continue to ensure that firms offering such structures are similarly scrupulous.

### 9.10 Licensing

9.10.1 In insurance as in other areas, the Island authorities vet applications for licenses carefully with a view to admitting quality.

9.10.2 The Guernsey and Isle of Man authorities have well-established procedures. Applicants are subject to "fit and proper" assessments. They have to submit 3- or 5-year business plans and personal particular forms for every key member of the applicant organisation. The applications are vetted in accordance with the "four-eyes" principle by at least two senior staff members.

9.10.3 In Jersey the vetting procedures are similar but understandably less well-developed. The main points for consideration are similar to those already mentioned in relation to the legislation.

### 9.11 On-going supervision

9.11.1 In all the Islands on-going supervision depends importantly on scrutiny by the FSC regulators of annual returns, including audited annual accounts, reports by consulting actuaries and auditors, and business plans. The Island regulators employ consulting actuaries and accountants to help in these tasks. For life insurance companies, the Guernsey and Isle of Man authorities require quarterly management accounts as well. As in the UK, on-site inspections are not well developed.

9.11.2 Some elements of good practice identified by the experts I have consulted, including some already mentioned above in connection with the legislative frameworks, are:

- *Annual accounts*. Insurers should preferably be explicitly obliged to draw these up in accordance with an acceptable GAAP relevant to insurance operations. The Jersey authorities do not at present have such a provision. It would also be helpful to clarify the limitations on their powers to waive the requirement for submission of accounts and auditor's reports, if such powers are retained.

- *Business plans*. Annual submission of updated business plans alongside the accounts, as required in all the Islands, should be a continuing requirement. For life insurance, the plans should preferably cover a 3- or 5-year period and be rolled forward each year.

- *Solvency margins and actuarial criteria*. The Island authorities need to keep minimum solvency margins under constant review against best international standards. There is a related need to ensure standard criteria or valuation rules for consulting actuaries so that reporting may be to a common standard.

- *Actuarial certificates*. Appointed actuaries should be required in their annual certificates to endorse the valuation basis used, the adequacy of records and the matching of assets to liabilities in nature and term.

- *Locally accountable management*. This is a key requirement in all jurisdictions. In Guernsey, as discussed earlier, registered insurers are required to appoint general representatives (usually the authorised insurance managers) to be the main on-going point of contact with the regulators. In the Isle of Man, the registered insurance manager fulfils a similar role.

- *Whistle-blowing*. Obliging auditors, actuaries, mangers and staff to whistle-blow to the authorities about breaches of regulatory procedures is a powerful device in ensuring compliance. The Islands' legislation could be strengthened in this area. The Jersey legislation already includes a valuable provision on these lines with regard to auditors.

- *Money laundering systems*. Life and other long term insurance products, especially single-premium, large deposit and re-insurance products, are potentially attractive vehicles for money laundering. The Isle of Man authorities have instituted especially good systems for combating money laundering in the insurance area, including a requirement that the annual Directors' Certificate and Auditors' Report certify full and effective compliance with the Island's money laundering guidelines. The Guernsey and Jersey authorities might like to consider adding a similar requirement.

- *On-site inspections*. The regulators in all the Islands are able to make on-site inspections in case of need. But such inspections have so far been ad hoc and infrequent.

As noted above, the UK's regulatory regimes have likewise made limited use of on-site inspections, well-established though they are in some other jurisdictions. This doubtless reflects in part the focus on prudential rather than conduct of business supervision.

Especially if the UK authorities move towards more on-site inspections, I hope that the Island authorities will do likewise. The authorities all have explicit powers to appoint reporting accountants, actuaries or other professionals as well as to make inspections themselves.

- *Procedures and manuals*. In all the Islands, there are "four-eyes" procedures for signing off annual returns from the supervised population. Up to date procedures manuals for dealing with such returns are an invaluable tool, especially when staff change.

### 9.12 Investigation and enforcement

9.12.1 For the most part, the authorities' powers to investigate, intervene and petition for winding up of insurers appear satisfactory. It is important that the prescribed procedures should facilitate swift and timely responses to regulatory problems.

### 9.13 Co-operation with overseas authorities

9.13.1 The Guernsey and Isle of Man authorities have powers to co-operate with regulators overseas in the pursuit of regulatory crimes or breaches. They devote considerable resources to such co-operation. One of the overseas authorities to whom I spoke particularly commended their co-operation.

9.13.2 The Jersey authorities' powers to co-operate exclude, among other things, information relating to persons who have transacted business with a permit holder. As discussed in Chapter 6, and for the reasons given there, I hope that the authorities will be willing to remove these limitations.

### 9.14 Protection of policyholders and Ombudsman

9.14.1 The Isle of Man has a statutory policyholder protection scheme funded by a retrospective levy. Based on the Life Assurance (Compensation of Policyholders) Regulations, 1991, the scheme applies to life assurance companies. It offers protection for up to 90 per cent of the liabilities of any life company that becomes unable to meet its obligations. It has not yet been activated. Payments under the scheme would be financed by a once-only levy (not, as in the Depositors' Compensation scheme or the UK's schemes a levy subject to an annual limit) on the remaining life assurance companies, up to a maximum of 2 per cent of the actuarial liabilities. The Island authorities have recently concluded, after a review with the help of independent actuaries and participants, that their scheme is sufficiently robust.

9.14.2 The Jersey and Guernsey authorities have alternative trust arrangements, applying to most offshore life insurance policies not covered by other protection schemes, which have been approved for the UK Financial Services Act 1986 Section 130 designated territory requirements. These require long-term insurers to arrange for 90 per cent of the assets (representing the liabilities to the policyholder) to be held by an independent trustee and placed with a custodian, both approved by the FSC.

9.14.3 As discussed in Chapter 6, the authorities in Guernsey and Jersey may wish to consider the introduction of Policyholder Protection schemes based on a retrospective levy, with arrangements if necessary to supplement levy funding. Such schemes offer protection in the event of a company's inability to meet obligations resulting from mismanagement as well as fraud. The issue is not, of course, entirely straight forward. When the Guernsey authorities last reviewed the matter, the actuaries advised that the small size of the industry at the time in relation to the high value of the funds of some of the companies would have made a retrospective scheme unworkable.

9.14.4 The insurance sector would fall within the ambit of the Financial Services Ombudsman scheme commended in Chapter 6.

### 9.15 Pensions

9.15.1 Some insurers in all the Islands offer contracts which they call pension products but are in effect savings vehicles. These are subject to regulation under the Islands' legislation for insurance and, in some cases, investment business. As discussed in Chapter 8, *all* long term insurance products should, in my opinion, be subject to conduct of investment business regulation.

9.15.2 None of the Islands has specific regulatory legislation in place for offshore pension schemes or a developed regime for supervision of such schemes.

9.15.3 The Isle of Man authorities have published a consultative paper on the development of such a regime. Based in part, but only in part, on the UK's Pensions Act 1995, the proposed regime would have strong trusteeship provisions, including "fit and proper" testing. It would also extend "whistle-blowing" obligations beyond auditors and actuaries to trustees, investment managers and scheme administrators. It would have minimum funding requirements as in the UK but based on a different methodology. There is no proposal at present for a compensation scheme. The UK's pensions ombudsman acts as ombudsman for Isle of Man occupational schemes, too.

9.15.4 In Guernsey, too, the authorities set up a pensions steering group in 1997 to consider a specific regime for regulation of pensions business.

9.15.5 Developing a supervisory regime will be a considerable task requiring considerable resources.

### 9.16 Priorities

9.16.1 In my assessment, the authorities in all the Islands should give priority at all times to ensuring that the supervisory regimes for longer term products, especially life assurance and related pension and investment products, are well-judged, effective and up to date. Within the area of commercial and captive insurance, supervision of third-party business deserves a special priority.

9.16.2 As discussed above, the authorities in each of the Islands are reviewing their legislation with a view to strengthening their supervisory regimes.

### 9.17 Resources

9.17.1 In insurance as in other areas, the Islands' regulatory authorities rely critically on one or two professional members of staff. Staff quality and experience are therefore all-important.

9.17.2 As to numbers, the Box 9.1 table indicates the present numbers of staff in post. The regulatory authorities in Guernsey and Isle of Man both propose, rightly in my opinion, to add one additional analyst (net) to their staff. With the possible exception of supervisory regimes for pensions, that should enable them to tackle the issues discussed in this Chapter. If the two regulatory authorities in the Isle of Man are merged, as discussed in Chapter 6, there could then be a compensating saving in support staff.

9.17.3 In Jersey, there are one and a half professional staff members, on a full-time-equivalent basis, dealing with insurance. The Insurance Director also devotes about one-quarter of his time to acting as finance director for the new FSC (potentially a considerable task during the FSC's first year or two of operation). The insurance sector remains small. As discussed above, however, there are important issues of legislation and supervision that need to be considered.

**BOX 9.1-Insurance Business and Supervision**

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| *Number of companies serving non-resident customers* | | | |

| | | | | |
|---|---|---|---|---|
| Total number of companies | | 13 | 354 | 192 |
| Of which: | | | | |
| Commercial & captives | | 10 | 344 | 177 |
| Life assurance funds | | 3 | 10 | 15 |
| Intermediaries | | na | na | 20 |
| Insurance managers | | 3 | 37 | 35 |
| UK parentage, per cent | | 21% | 77% | 75% |
| *Scale of business* | | | | |
| Annual gross premium income, bn: | | 0.023 | 2.139 | 3.1 |
| Commercial & captives | | 0.022 | 1.578 | 1.0 |
| Life assurance etc | | 0.001 | 0.561 | 2.1 |
| Assets, bn: | | 0.416 | 7.4 | 12.3 |
| Commercial & captives | | 0.367 | 5.2 | 4.7 |
| Life assurance etc | | 0.049 | 2.2 | 7.6 |
| Proportion of premium income from UK sources, % | | 10% | 60%* | 55% |
| *Staff in the industry* | | | | |
| Employed in the industry | | 20 | 380* | 1,657 |
| Of which: | | | | |
| Commercial & captives | | 2 | 5* | 30 |
| Life assurance etc companies | | 10 | 140* | 1500 |
| Insurance Managers | | 8 | 230* | 100 |
| Intermediaries | | | 5* | 27 |
| *Regulator staff* | | | | |
| Total, FTEs | | | | |
| Of which: | | 1.5 | 6.5 | 5 |
| Commercial & captives | | 1.25 | 6 | 4 |
| Life assurance etc & pensions | | 0.25 | 0.5 | 1 |
| *Supervisory ratios (per regulator staff member in the appropriate category)* | | | | |
| Commercial companies and captives: | | | | |
| Nos | 2/20 | 8 | 56 | 44 |
| Staff (inc managers) | (15+17)/20 | 1.6 | 39* | 32 |
| Premium income | 8/20 | 0.02 | 0.263 | 0.25 |
| Life assurance etc companies | | | | |

| | | | | |
|---|---|---|---|---|
| Nos | 3/21 | 12 | 12 | 15 |
| Staff | 16/21 | 40 | 280* | 1500 |
| Assets | 12/21 | 0.2 | 4.4 | 7.6 |

**Estimate*

### 10.11 Regulatory priorities

10.11.1 The Island authorities are concerned to take all reasonable steps to minimise the scope for abuse of the facilities they offer for companies to be incorporated in the Islands and/or to carry on business there.

10.11.2 They are also concerned, understandably so, not to introduce regimes that would drastically reduce their companies business and hence the earnings from their Finance Centres. The practitioners in the Islands argue that many clients of high repute have deep concerns about privacy even though they have nothing to hide and that requirements for comprehensive public disclosure would lead to the loss of much good business as well as bad.

10.11.3 In my opinion, such fears may be exaggerated. There is no obvious reason, for example, why an EU-style disclosure regime should deter any legitimate corporate sector business. But there is little doubt that increased disclosure requirements will lead to some diversion of business.

10.11.4 With these considerations in mind, the authorities in each Island have given priority to developing new policies for the licensing and regulation of company service providers. As mentioned earlier, these service providers play a key role in the Islands' companies business. In my opinion, therefore, the Island authorities have been right to give priority to this area. Chapter 13 discusses the regulation of company and Trust services providers.

10.11.5 Important as the regulation of service providers is, it will not in my opinion be sufficient in itself. If the Islands' company sectors are to be well-regulated, the authorities will also need to introduce or to continue, as the case may be, the good practices discussed above on

- vetting,
- confidential disclosure of beneficial ownership, including changes, and
- registration of companies operating or administered locally but incorporated elsewhere.

10.11.6 The authorities ought also, in my opinion, to have powers to investigate companies in case of need. As discussed above, the Guernsey authorities do not at present have such powers.

10.11.7 The requirements for audited accounts and public filing of financial information (abbreviated for most companies) are likewise, in my opinion, significant elements in good practice even though the United States and Canada confine such requirements to listed companies. Ideally they would be introduced as part of a common initiative by finance centres generally, and in particular by offshore centres.

10.11.8 In the meantime, there are lesser measures, as discussed in the previous section, which would be valuable, not least in relation to combating potential abuse of company vehicles. I hope that the Island authorities will consider these.

### 10.12 Companies by tax status

10.12.1 In contrast with most of the larger countries, but in common with other offshore or quasi -offshore centres, the Islands offer various options for special company tax regimes designed to attract international business and the related fees. Companies can therefore be analysed by tax status as well as by regulatory status. As the Box 10.1 table indicates, more than half the companies in each of the Islands are tax exempt or have other forms of non-resident or special tax status.

10.12.2 Although terminology and details vary between the Islands, there are three main tax categories of company in each of them, one designed for local businesses and asset holders, one for non-resident asset holders and one for non-resident-owned international business:

- *Resident income tax companies*. Companies in this category include most local businesses. They pay tax at 20 per cent on their profits. Except in Guernsey (where there are different arrangements), dividends and interest, apart from deposit interest, are subject to a withholding tax of 20 per cent, which is credited against income tax liability.

- *Exempt or Tax exempt companies*. These are primarily designed for use as investment vehicles. Holding companies within corporate groups, trading entities and asset holding companies like to use this format, as do captive insurance and collective investment scheme companies. Wealthy individuals overseas (or the Trusts they have established) may hold assets of any kind in these vehicles, including physical assets, investment portfolios, business interests or intellectual property rights. Familiar in other offshore centres, too, they account for the majority of Island companies. They may be registered either in the Islands or overseas but must be beneficially owned by non-residents. If they are registered overseas, a significant element of management or control in the Islands is required (the details varying from Island to Island). Board meetings may be held in the Islands. These companies pay a flat-rate annual fee of between 300 and 600 (2,000 for insurance companies in the Isle of Man). In return for this, they are exempted from income and withholding taxes (except on any local non-interest income). There are no capital gains or inheritance taxes on the Islands.

- *International or International Business Companies (IBCs)*. These are special vehicles, familiar in all offshore centres, designed to help international or overseas companies to minimise their world-wide tax burden. Less numerous than tax-exempt vehicles, they are typically used by international groups for purposes such as head office and treasury functions or by insurance companies. Like exempt companies, IBCs may be registered either in the Islands or overseas but must be beneficially owned by non-residents and engage only in overseas business. They negotiate with the Island authorities a rate of tax, usually between 0 and 2 per cent but sometimes substantially higher, which will minimise their parent company's world-wide tax burden.

10.12.3 In addition to these main types of company, Jersey and the Isle of Man have some special categories.

10.12.4 Jersey and Guernsey both have a special category of foreign registered investment companies. Although administered locally, these companies pay no taxes or fees provided (in Jersey but not Guernsey) that at least one Director is a local resident. In contrast with *foreign registered exempt companies*, they are not required to disclose their beneficial ownership to the Jersey or Guernsey Tax or Company authorities, though the professionals seeking this concessionary treatment are expected to satisfy themselves that they know the beneficial owners. The Isle of Man does not have such a category.

10.12.5 In my opinion, there are risks in hosting business about which the authorities have no knowledge. Regulation and disclosure requirements would better be applied to these companies in the same way as to others.

10.12.6 The Isle of Man has a special category of *locally incorporated non-resident companies*. These companies are incorporated in the Island and have therefore to submit some basic information at the time of registration. But provided that all their business is controlled and conducted outside the Island (and that all their income, other than approved interest, arises outside the Island), they are able to qualify as non-resident for tax purposes. This means that they have no liability to tax in the Island beyond the flat-rate non-resident company duty of 750 a year, though the Island tax authorities may challenge the non-resident designation.

10.12.7 This form of company vehicle seems to me to have three troublesome features:

- First, these companies are able to use the Island's name and incorporation facilities even though the information the authorities have about them is limited. As with other Isle of Man companies, there is no vetting and no requirement to disclose beneficial ownership. Other information, too, is limited. Under the authorities' proposals discussed in Chapter 13, however, corporate services providers administering the companies will be expected to know their customers.

- Second, and conversely, the owners of such companies are able in practice to keep secret their own identities and the activities and finances of the companies. That said, the Island's Companies Act 1931 requires that the registered addresses of the companies and the names of the Directors, shadow Directors and Company Secretaries be publicly filed, and the Island authorities have powers under which they are able to investigate such companies if required.

- Third, the combination of secrecy and non-residence for tax purposes makes such companies attractive vehicles for evasion of taxes in other jurisdictions. Some administrators of such companies are known to engage Directors in

Sark or other tax-free locations so as create the fiction that the companies are controlled in such locations and hence resident there for tax purposes. With the help of such Directors, who in many cases appear to have no knowledge of the company's activities, owners of the companies may be able to escape tax altogether as well as masking other activities. Chapter 11 discusses the problem from the point of view of those who serve as "nominee" Directors.

10.12.8 The Isle of Man authorities are reviewing the future of these locally incorporated non-resident companies as part of an on-going initiative to update company regulation. Several of those whom I consulted on the Island thought that this category of company should be abolished. I agree with them. If companies cannot qualify as normal tax paying companies, tax-exempt companies or international business companies, they should preferably not be incorporated at all.

### 10.13 "Harmful tax competition"

10.13.1 In recent international discussions, the larger industrial countries in the Group of 7 and the OECD have raised the question whether offering preferential company tax vehicles along the lines described in the previous section to non-residents constitutes harmful tax competition.

10.13.2 The larger countries tend to see such vehicles as diverting business from their own countries and facilitating tax avoidance. Other countries, however, including offshore centres, have argued that the issues are by no means straightforward. For offshore centres in particular, these vehicles are an important source of earnings. Individual centres compete with each other for the business.

10.13.3 These issues lie beyond the scope of the present report. In my opinion, they will have to be discussed and resolved at an international level. The Islands have made clear that they wish to play a full and constructive part in global discussions.

### 10.14 Bearer shares

10.14.1 The Islands vary in their approach to bearer shares. Jersey and Guernsey do not permit them for locally incorporated companies but companies registered elsewhere may have them.

10.14.2 In the UK and the Isle of Man, companies are permitted to issue share warrants which resemble bearer shares. The bearer of the warrant is entitled to the share specified in it and title passes by delivery of the warrant. In practice, however, bearer securities have never been popular with English or Isle of Man investors or companies and are mainly issued for bonds rather than shares.

10.14.3 In my opinion, there is a presumption against permitting bearer shares. Such instruments enable the unscrupulous to conceal their ownership of companies without offering any significant compensating advantages.

### 10.15 Insolvency and bankruptcy: existing regimes

10.15.1 The remaining sections of this chapter draw heavily on a review of the bankruptcy and insolvency regimes in the Islands commissioned by the Home Office at my request from Mr Guy Sears. I am most grateful to Mr Sears.

10.15.2 All the Islands have well-established regimes for dealing with bankruptcies and corporate insolvencies. As in other jurisdictions, these regimes take the distribution of assets out of the debtor's hands:

- Jersey has a unified modern procedure, known as desastre, for persons and companies, and separate modern procedures for winding up companies.

- Guernsey has old Laws dealing with bankruptcy of individuals and insolvency of partnerships and a more modern law, dating from 1994, on company insolvencies, based on the UK's Insolvency Act 1986. There are also common law procedures for vesting the debtor's real property in the creditors (saisie) and distributing his personal property among them (desastre).

- The Isle of Man has old legislation, based on still older UK legislation, on bankruptcy and corporate insolvency. A working party in 1994 recommended new legislation incorporating a range of reforms. The authorities hope to bring

forward an Insolvency Bill in the next session of the Island's Parliament.

### 10.16 Insolvency and bankruptcy: main issues

10.16.1 Mr Sears has made two main proposals for improving the Islands' bankruptcy and insolvency regimes:

*(a) Rescue procedures*

10.16.2 With some limited exceptions in Jersey and for Protected Cell Companies in Guernsey, none of the Islands has modern procedures for enabling businesses to be rescued, in appropriate cases, rather than made insolvent. There are no procedures comparable to administration in England.

10.16.3 Mr Sears has suggested that the authorities in all the Islands would do well to bring in a new procedure allowing companies to obtain a moratorium on action by creditors for (say) 28 days. Within that period rescue proposals could be made which if approved by a requisite majority of creditors could bind the creditors as a whole.

10.16.4 The UK authorities have consulted about such a proposal but have not yet resolved how to implement it alongside floating charges and administrative receivers.

10.16.5 The Isle of Man authorities propose to include a rescue procedure on these lines in their forthcoming legislation on Insolvency, in accordance with the recommendations of a Working Party which reported in 1994. As in the UK, the authorities will have to decide how to deal with floating charges.

10.16.6 The Jersey authorities, too, have plans to introduce a rescue procedure. The authorities have produced draft proposals for consultation. For both Jersey and Guernsey, introduction of the procedure would be relatively straight forward. As discussed in Chapter 7, the Guernsey authorities would have found such procedures invaluable in the Barings Bank collapse of 1994.

*(b) Official Receiver or equivalent*

10.16.7 The public interest sometimes requires that companies be put out of business even though no private sector person is willing to take the initiative in making it happen. The requirement may arise because the companies are insolvent or for other reasons.

10.16.8 In all jurisdictions, therefore, suitably constituted public bodies are needed with responsibilities, powers and means to investigate any such companies and petition the Courts to wind them up in the public interest.

10.16.9 Also needed are implementing bodies which will carry through the practical business of the insolvency in the public interest where the situation so demands (for example, where no assets are available to finance private liquidators).

10.16.10 Without bodies of both kinds, or bodies which combine both functions, there is a risk that no one will wish, or no one will have the locus or the money, to wind the companies up, disqualify Directors or return assets to creditors. The bodies need to have means as well as powers, including access to public funds.

10.16.11 In Jersey, the Viscount's office includes among its responsibilities the implementing function described. The Viscount has the powers and means to discharge this function.

10.16.12 Guernsey does not have a corresponding body but the authorities are considering the case for introducing one. In the meantime, the Advisory and Finance Committee of the Island's Parliament can petition for the winding up of a company to protect the public or the Island's reputation.

10.16.13 The Isle of Man likewise does not at present have such a body but the authorities have proposals to introduce an Official Receiver. Meanwhile, the Courts can appoint Official Receivers for individual cases and the FSC regularly petitions the Courts to wind up companies in the public interest.

10.16.14 The public body concerned should preferably have responsibility for two related matters, both identified by Mr Sears:

- *Ascertaining access to assets held in Trust*. The body should be responsible (as the Viscount in Jersey already is) for asking the Courts in appropriate cases to direct how Trust assets (not normally available to creditors) should be applied as well as for dealing with distribution of the other assets. HM Procureur in Guernsey has similar powers.

- *Licensing and supervision of insolvency practitioners*. Self-regulation for insolvency practitioners seems to me a less good alternative in jurisdictions such as the Islands where practitioners tend to come from different backgrounds. In Jersey the Finance and Economics Committee has already prescribed what qualifcations liquidators must have.

10.16.15 The FSCs, too, should have powers, as in the Isle of Man, to ask the Courts to wind up any company, whether licensed or not, carrying on an activity for which a licence is needed. Anyone who brings an insolvency application against licensed firms (or firms which ought to be licensed) should also be obliged to inform the FSCs. This is already the case in Guernsey.

10.16.16 In my opinion, the authorities in Guernsey and the Isle of Man will be well-advised to include the full range of powers described above in the proposals they have for updating their insolvency regimes and legislation.

### 10.17 Insolvency and bankruptcy: other issues

10.17.1 Some other issues examined by Mr Sears were:

- *Universality and non-discrimination*. In all the Islands, insolvency orders apply to all assets wherever located. There is likewise no discrimination between domestic and overseas creditors.

- *Set-off*. The Islands have differing but reasonable provisions for setting off mutual debts and credits.

- *Discharge period*. Guernsey law does not provide for a fixed discharge period for people declared bankrupt. A period of between 2 and 4 years would be normal.

- *Partnerships*. The procedures for insolvency of partnerships in Guernsey are based on the UK's Partnerships Act 1890. Partnerships should arguably be treated for this purpose like companies.

- *Transactions prior to bankruptcy or corporate insolvency*. The Isle of Man and Guernsey provisions for setting aside such transactions may need to be updated.

- *Overseas companies*. The Jersey and Isle of Man authorities, like the UK, have powers to wind up overseas companies. In Guernsey, the FSC can wind up overseas banks and insurance companies but not overseas investment or other companies.

- *Licensing of insolvency practitioners*. The requirements vary between the Islands. As discussed above, licensing by the office of the Official Receiver or equivalent has much to commend it.

- *Redress against liquidators and others*. In all the Islands, the Courts can remove from office the corporate liquidator, the trustee in bankruptcy or other office holders. Aggrieved persons can sue them for breach of duty or misapplication of assets. The Courts should preferably be given powers, too, where they do not have them already, to investigate the actions of liquidators and other office holders and oblige them on a summary basis to pay or account.

- *Disqualification of Directors*. Directors can be called to account or disqualified in all the Islands. As discussed in Chapter 11, however, there is some question, at least, whether these powers have been sufficiently used.

- *Information from debtors*. The Islands appear to have provisions requiring debtors and other relevant persons to give information to the Court.

- *Wrongful trading*. The Isle of Man does not at present have wrongful trading provisions, except in relation to fraudulent Directors and others, but proposes to introduce them in the forthcoming Bill.

- *Shadow Directors*. Shadow Directors, from whom the Directors take instructions, should be held liable along with the Directors for wrongful trading. This appears to be the case in all the Islands.

- *Provisional liquidators*. These can be appointed in Guernsey and the Isle of Man to prevent dissipation of assets. In all the Islands, Mareva-style injunctions can be issued.

- *Mutual recognition of insolvency orders*. In Jersey and Guernsey the judicial authorities have statutory obligations to recognise insolvency orders and office holders in the UK and in other named jurisdictions where there are arrangements for mutual recognition. In the Isle of Man, such recognition is at present limited to bankruptcy cases. The forthcoming legislation will provide an opportunity to correct this. The common law in all the Islands allows for recognition of orders from other jurisdictions on the usual grounds of comity.

10.17.2 The Island authorities may wish to consider this checklist of points, as well as the major issues on moratoriums and official receivers discussed earlier, when updating their insolvency and bankruptcy regimes.

**BOX 10.1-Companies in the Islands**

*numbers of companies, January 1998*

| | *Jersey* | *Guernsey* | *Isle of Man* |
|---|---|---|---|
| *By incorporation* | | | |
| Locally incorporated | 32,272 | 16,204 | 41,980 |
| Operating or administered locally but incorporated elsewhere: | | | |
| F register | | | 1,870 |
| Not registered* | na | ?20,000 | 1,000 |
| TOTAL | na | ?36,204 | ?44,850 |
| *By tax status* | | | |
| Companies paying standard 20 per cent company income tax | 15,595 | 7,695 | 20,055 |
| Tax exempt companies | 19,371 | 8,362 | 13,263 |
| International business companies (or equivalent) | 123 | 147 | 39 |
| Foreign incorporated investment companies | 4,774 | | |
| Locally incorporated companies treated as non-resident for tax purposes | | | 10,398 |
| LLCs | | | 95 |
| Other foreign incorporated companies not subject to Island company income tax | na | ?20,000 | 1,000 |
| TOTAL | na | ?36,204 | ?44,850 |

**Estimate*

### 12.8 Possible improvements to existing legislation

12.8.1 Professor David Hayton has identified a number of possible changes or additions that might be considered in one or more of the Islands' Trust legislation.

12.8.2 To counter potential abuses by settlors, he has suggested that the following provisions should be considered where they do not apply already:

- *Defrauding creditors*.

  (a) As in England, a settlor should not be allowed by means of a Protective Trust created in favour of himself to protect his assets against creditors if he goes bankrupt at any time in the future. At such time, the settled property should, as in the UK, pass to his trustee in bankruptcy.

  (b) Again as in England, any Trust intended to prejudice the settlor's future unascertained creditors should be allowed to be set aside by such creditors for the first 5 or 10 years of its life. Such Trusts could include, for example, discretionary Trusts in favour of the settlor, his spouse and their descendants. (In the Isle of Man it is unclear whether the Court's general power to set aside transactions intended to defeat creditors applies to future unforeseeable creditors as well as existing or contingent creditors.)

  (c) When non-resident settlors go bankrupt, their creditors should have the same ability to recover assets as they have from Island-resident settlors.

- *Frustrating legitimate claims of heirs and spouses*. As in England and the Isle of Man, Courts should have powers (where they do not already do so) to set aside:

  (a) Trust (or other) arrangements made by locally domiciled settlors up to 6 years before their death to defeat the legitimate claims or expectations of family or dependants under mandatory family protection rules, and

  (b) similar arrangements made to defeat financial claims by divorcing spouses under the Islands' divorce jurisdictions, especially where the arrangements were established up to 3 years before the claims are made (and may thus be presumed to have been made to defeat such claims).

- *Flee clauses*. The legislation could usefully include specific examples of events (such as the bringing of criminal charges or restraint orders) that may not trigger "flee clauses" (providing for automatic replacement of the existing trustees by new trustees in certain eventualities). These would supplement general powers to regard such clauses as void for public policy reasons. Including specific examples in the legislation would improve the chances of co-operation by overseas jurisdictions when such clauses are triggered for disreputable reasons.

12.8.3 To counter potential abuses by trustees, Professor Hayton has suggested that the following provisions should be considered where they do not apply already:

- *Number of trustees*. As in England, for land at least, sole trustees should never be permitted. To guard against dishonesty and negligence, there should always be at least two individual trustees or a properly constituted Trust provider company. The four-eyes principle can then be applied.

- *Requirements to inform beneficiaries and objects of a discretionary power*. Two particular changes that would help to combat possible failures of accountability and possible abuses associated with blackhole trusts and the absence of any rule against accumulation are:

  (a) The legislation should preferably be explicit in requiring trustees to inform existing persons of full capacity having vested or contingent interests that they are beneficiaries; and, if there are fewer than two such beneficiaries,

to inform, so far as practicable, at least three existing persons of full capacity within a larger number of discretionary objects of a power that they are objects. If recent recommendations by the Law Commission in England (1998) to extend perpetuity and accumulation periods to 125 years should be implemented, this proposal would apply with equal force to English Trusts.

(b) Trustees should also be explicitly obliged to show beneficiaries and representative objects key documents relating to the Trust, including the Trust Deed and annual accounts (but not letters of wishes if the settlors explicitly or implicitly intended them to be confidential to himself and the trustees). The legislation should nullify any attempts to remove this right. It should, however, permit the trustees in exceptional circumstances to refuse to reveal information to a particular beneficiary if this might harm the interests of other beneficiaries (for example, where one beneficiary's personal interest in a business conflicts with the business interests of the rest).

- *Liability of trustees for negligence*. Jersey and Guernsey are in advance of England in prohibiting exemption clauses which exempt trustees from liability for gross negligence. The law in all the Islands should preferably, however, prohibit or nullify clauses exempting trustees from liability for negligence of any kind, ordinary or gross (as well as for dishonesty). The Trust Law Committee is recommending such a provision in England (where *Armitage v Nurse* recently established that, as things stand, an express exemption clause can exempt trustees from liability for gross negligence). The Turks and Caicos Islands already have one.

- *Waiver of privilege against self-incrimination*. The law (in England as well as the Islands) should preferably require waiver of the privilege against self-incrimination as a condition of all future trusteeships.

- *Enforcers for Purpose Trusts*. If the Islands wish to have Purpose Trusts, they should have legislation as in the Isle of Man's Purpose Trust Act 1996 making such Trusts subject to inspection by the Attorney General or an officer of the Court. The legislation should make clear that this and other requirements on Purpose Trusts apply equally to Trusts where there is a provision for any residual assets at the end of the Trust period to pass to persons or charities.

12.8.4 Professor Hayton has also commended a suggestion by Mr Peter Willoughby that, for the avoidance of doubt, the Jersey, Guernsey and Alderney authorities might add to their Trust legislation a provision along the lines:

> *The equitable maxims and remedies of English law that underpin English Trust law also apply to underpin Jersey/Guernsey/Alderney Trust law.*

12.8.5 Professor Hayton has suggested, finally, that if the Island authorities should introduce an optional registration system for trustees there could be a requirement for non-registered trustees to obtain independent professional auditing of trust funds in excess of some specified amount. These matters are considered further in a later section.

### 12.9 Case for regulating Trust service providers

12.9.1 The Island authorities have no proposals to regulate or register Trusts as such. They do all propose, however, to extend the regulatory boundary to include professional providers of Trust and trustee services.

12.9.2 The Jersey and Guernsey authorities propose to introduce legislation to this end soon, with a view to early implementation of the new regimes. The Isle of Man authorities propose to do so after completion of their proposed legislation for corporate services providers.

12.9.3 This legislation may also offer a convenient opportunity to enact, where appropriate and where the Island authorities so decide, the other points suggested above by Professor Hayton.

12.9.4 In my opinion, the Island authorities are entirely right to extend the regulatory boundary in the way proposed. As discussed above, the scope for abuses is considerable. The sooner the boundary can be extended, therefore, the better.

12.9.5 The Island authorities are also right, in my opinion, to focus the regulatory regime on Trust companies or service providers rather than Trusts themselves. This is the route which the British Caribbean Territory authorities and Bermuda, too, have followed.

12.9.6 To require the registration and regulation of Trusts, as such, would be an enormous undertaking, comparable with the

registration of Companies. It would also be likely to deter customers who wish privacy in their family and personal arrangements.

12.9.7 The more practical course, therefore, is to extend the regulatory boundary, as proposed, to cover professional providers of trustee and other Trust services, whether in banks, accountancy firms or law firms or independents. This seems to me not only the most economical, but also the most effective, way to regulate the sector, to the extent that regulation is needed.

12.9.8 There are some who say that there is no need to regulate a sector which mainly serves companies and relatively prosperous people. If they choose bad trustees and make bad Trust arrangements, so the argument runs, that is their fault. Provided that there is a satisfactory legal framework, offering the aggrieved the chance of redress, there is no need for regulation.

12.9.9 In my opinion, such arguments are too cavalier. The more persuasive arguments are:

- First, the regulatory authorities of international finance centres cannot lightly remain inactive if crooked or incompetent people are abusing customers of the centre.

- Second, such abuses, if they occur, may destroy the reputation of a whole industry and finance centre. The expectation has grown, and continues to grow, that international finance centres will be well regulated and will not permit abuse.

- Third, a good legal and judicial framework is undoubtedly essential. But such a framework *punishes* abuse, often at great cost, after it has happened. It is far better to *prevent and deter* abuse from happening in the first place, through suitable regulation. By the time the Courts are involved, the damage has been done.

12.9.10 The Trust service providers, or their customers, should however be expected to cover the cost of regulation through the providers' registration fee.

### 12.10 A possible regulatory regime

12.10.1 As in the British Caribbean territories and Bermuda, where Trust service providers have been subject for many years to licensing, *legislation* will be needed to establish the regulatory regime.

12.10.2 In the Caribbean territories, the legislation mostly forms part of the local banking legislation and is drafted with banks rather than Trust service providers primarily in mind. In the Crown Dependencies the legislation will take the form of a separate Law covering either Trust service providers or, preferably in my view, *all* Trust and Corporate service providers (see Chapter 13).

12.10.3 The Law will need in my view to cover broadly the following points (a fuller version is in Chapter 13, Box 13.1):

- The Financial Services or Supervision Commissions (FSCs) would be tasked to act as registrars and regulators of Trust Service providers.

- All professional providers of trustee or other Trust services would be required to apply to the FSCs for registration. It would be an offence to provide such services without registration.

- In deciding whether to grant registration, the FSC would be obliged to take all reasonable steps to satisfy itself that the applicants were fit and proper, in terms of integrity, solvency, competence, track record and technical support, and had adequate capital and insurance;

- The FSC would draw up with the industry a Code of Conduct with which registered providers would be expected to comply. Some elements in the Code might be given specific statutory effect.

- The FSC would have powers to inspect and obtain information from providers for purposes of enforcement and to name, warn and disqualify them if they fail to comply on a continuing basis with the fit and proper tests and the Code of Conduct.

- The providers would be obliged to submit annual returns to the FSC, including an audited compliance return and audited accounts.

12.10.4 For the *Code of Conduct*, there are again some Caribbean precedents, notably the British Virgin Islands' "Code of Conduct for the performance of licensed members of the Association of Registered Agents", which is about to receive statutory force. The accompanying Box 12.1 summarises the coverage of this Code.

12.10.5 In the Crown Dependencies, the Code could be along similar lines. It would preferably, however, deal more specifically with the key areas of risk and potential abuse associated with Trusts, and the means for dealing with them, including those discussed above:

- possible attempts to conceal and protect assets from creditors;
- possible attempts to hide the proceeds of crime;
- sham Trusts;
- custodians, protectors and enforcers;
- disclosure of key information to beneficiaries and objects;
- such information to include annual accounts and fees (independently audited for the larger Trusts).

12.10.6 Box 12.2 gives an illustrative sketch of what a Code for the Crown Dependencies might cover.

12.10.7 It would be possible to have two categories of Trust service providers, registered and unregistered. Settlors would then have the option of employing providers from one group or the other. The problem with this, however, is that unregistered providers could all too easily bring the Islands' finance centres into disrepute. It seems far better, therefore, to require all providers to be registered.

### 12.11 Issues of transition

12.11.1 The Island authorities recognise that, in this as in other sectors, the transition from non-regulation to regulation will require careful handling.

12.11.2 In my opinion, there are two important considerations which apply to transitions generally.

- First, the initial registration process should set high standards. It should be used to weed out dubious or incompetent providers. The initial process will provide the best opportunity there has ever been, or will ever be, to achieve this without being unfair to anyone. It is far easier not to register in the first place than to remove a registration previously given.
- Second, the authorities should make clear publicly, well in advance of registration day, how tough the initial registration process will be. This will greatly facilitate the task of weeding out. As with choir auditions, many of the more marginal providers are likely not to apply rather than apply and be turned down. This makes the whole process more manageable and more acceptable.

12.11.3 In the expectation of future regulation, the Guernsey authorities have authorised only limited numbers of new fiduciaries since 1984.

12.11.4 In the area of Trusts there is a special problem of transition: what happens to the Trusts whose trustees fail to qualify for registration? Clearly some arrangements must be made to ensure that successor trustees are appointed from among the ranks of the registered.

12.11.5 In many cases, this should not present any problems. There may however be Trusts which no other trustees would willingly take over. Some fall-back arrangement, preferably not dependent on Court hearings in each individual case, is likely to be needed.

12.11.6 To deal with such problems, which may in some cases be difficult, the legislation might provide that after D-day trustees not registered should:

- appoint new trustees as soon as practicable from the ranks of the registered trustees with the agreement of protectors and/or enforcers and after informing beneficiaries and objects;
- in the absence of volunteers, invite the Attorney General or an officer of the Court to assume responsibility for appointing new trustees or temporary trustees;
- in the meantime, take no action on their Trusts other than to preserve the value of the Trust assets.

12.11.7 The Attorney Generals or officers of the Court would need a corresponding power to appoint trustees or temporary trustees at the expense of the Trust concerned and to go to Court in cases of blackhole Trusts or Trusts with no adult beneficiaries.

12.11.8 This, however, is only one approach. The Attorney Generals or officers of the Court or the Islands' FSCs could alternatively take responsibility for providing (or petitioning the Court to provide) temporary and then permanent trustees for all the Trusts concerned.

### 12.12 Comparison with the UK

12.12.1 As discussed earlier, I am sure that the Island authorities are right to extend the regulatory boundary to cover providers of Trust services even though the UK has not yet done so.

12.12.2 I hope that the UK authorities will consider extending the regulatory boundary in a similar way.

12.12.3 The considerations that point to taking this step in the Islands may not seem so pressing in the UK. In my opinion, however, they are equally compelling.

12.12.4 A further consideration is that, when the Island authorities carry out their plans, the less reputable providers may in some cases move to the UK if the UK makes no matching move.

12.12.5 A valuable by-product of such a step is that it would open the way to create for the first time inside the UK Government, or the Financial Services Authority, a group of people with a clear responsibility for overseeing the Trust sector.

12.12.6 This too is much needed. Some on-going oversight of the sector, and the law that governs it, will help to ensure that the sector realises its potential for good while minimising the risks and abuses described in this Chapter.

12.12.7 Trusts have been and remain a unique and invaluable element in the facilities offered by the Common Law jurisdictions. Without a measure of regulation and oversight, however, they could all too easily fall into disrepute.

### BOX 12.1-British Virgin Islands (BVI): Code of Conduct for the performance of Licensed Members of the BVI Association of Registered Agents

The new BVI Code covers: Objectives of the Code:

- BVI reputation
- deter criminals
- protect members

monitoring of compliance through an annual audit

staff training

relationships with clients, including:

- Establishing a suitable paper trail in all cases
- knowing the clients
- knowing clients' needs and putting their needs first
- checking that professional service clients are of adequate standing and have suitable due diligence procedures for the beneficial clients
- knowing the identity of end-user clients and obtaining a banker's reference
- protecting client confidentiality
- charging just and proper fees
- where fiduciary services are provided, maintaining records and checking that Trust assets are not of criminal origin.

Procedures for transfers of clients

Procedures for disciplining, sanctions and appeals

Arrangements for modifying the Code.

**BOX 12.2-Trust Service Providers: Illustrative Sketch for a Code of Conduct**

Trust Services Providers are required:

- to promote the objectives of the Code, which are:

  to ensure the highest standards of integrity and professionalism in the service of clients,
  to prevent criminal or regulatory abuse, and
  to maintain and enhance the reputation of the Island;

- to act at all times with honesty and integrity and to apply the "four eyes" principle;

- to know the settlors and undertake the necessary due diligence;

- to investigate the provenance of the assets proposed for the Trust and to ensure that they are not the proceeds of crime;

- to ensure that proposed Trust arrangements would be sustainable if publicly known and are not a device to conceal assets or put them beyond reach of creditors, tax authorities or other injured parties;

- not to set up or participate in sham Trusts where the trustees merely carry out the settlor's instructions and have no significant discretion;

- to consider with the settlor at the outset whether there should be an independent Custodian of assets or a Protector;

- to invest, distribute and otherwise manage the Trust's assets in accordance with the purposes defined in the Trust deed and any letter of wishes from the settlor;

- to disclose to beneficiaries and representative objects of a power, unless there are decisive reasons to the contrary:

  the fact that they are beneficiaries or objects of a power;
  the Trust deed and the settlor's letter of wishes;
  the identity of the Custodian, the Protector and the Enforcer;
  the annual accounts, audited as appropriate, including fees charged;

- to co-operate with the Island authorities if they need information in the pursuit of enquiries into possible criminal behaviour or breach of regulation;

- apart from the above disclosures, to keep the Trust's affairs confidential;
- to ensure that the funds of individual Trusts are totally segregated from each other and from the provider's and custodian's own funds;
- to manage the investment of individual Trust funds professionally and responsibly;
- so far as practicable, to exercise professional oversight of any companies owned by the Trust;
- to charge a reasonable level of fees, in accordance with published local industry guidelines;
- to prepare and preserve annual accounts for all Trusts, including a statement of fees charged;
- to send the accounts to beneficiaries or representative objects, as appropriate, and if required to the settlor or a protector or an enforcer;
- to have the accounts independently audited if the assets exceed 500,000;
- to keep minutes of meetings, records and files;
- to deploy sufficient staff with the required skills and training to look after the Trust's affairs and apply the four-eyes principle;
- to maintain adequate levels of working capital and Professional Indemnity and Employee Fidelity Insurance and to inform clients in suitable terms about them;
- to manage transfers of clients in accordance with the procedures defined in the law or by the FSC;
- to have an independent annual audit of their compliance with the legislation and the Code;
- to co-operate fully with the FSC and in particular:

    to pay the annual registration fees,
    to submit the provider's own annual audited accounts (including a statement of fee rates),
    to submit the annual compliance audit,
    to submit such other information as the FSC may require, and
    to co-operate in disciplinary and disqualification procedures.

### 13.8 Lawyers and accountants

13.8.1 In contrast with some other offshore jurisdictions, the Islands all have substantial numbers of resident lawyers and accountants to serve the heavy requirements of their international finance centres. The numbers in the accompanying table are not counted on a consistent basis and may not, therefore, be entirely comparable.

| | Lawyers | Accountants |
|---|---|---|
| Jersey | 270 | 500 |
| Gurnsey | 122* | 476 |
| Isle of Man | 166 | 444 |

*Estimated

13.8.2 In the Islands as in other jurisdictions, the members of these professions undertake much of the Trust and Company formation and administration business, often but not always through separate companies. The Islands' finance centres rely heavily on them.

13.8.3 As with other professionals operating in these areas, unscrupulous or incompetent practitioners can do great harm by promoting, facilitating or turning a blind eye to disreputable schemes and practices.

13.8.4 There have been some recent examples of this involving (among others) people in the Islands. In the *Agip (Africa) v Jackson and others* case, heard by the High Court in England in 1990, an accountant and another employee of an accountancy firm on the Isle of Man were found to have facilitated the laundering of money fraudulently misappropriated from Agip (Africa) with the help of client accounts in the Isle of Man and companies registered in England. The Isle of Man section mentions the case. In the *Charlton* case, heard by the Crown Court in England in 1994 and by the Court of Appeal in 1995, not mentioned in the Jersey section, accountants on Jersey together with others in the UK were found guilty of cheating the public revenue through schemes typically involving false purchases by UK companies from Jersey companies designed to disguise the full amount of the profits they had made.

13.8.5 The Island authorities have decided that the best way to ensure high standards of integrity and competence among its professional groups is through regulation of particular functions and services, such as Trusts business and Company business, and those who provide them, irrespective of the providers' professional backgrounds.

13.8.6 The many lawyers ands accountants who provide such services will therefore be obliged to apply for licences and submit to regulation, in the ways discussed in this Chapter, just like other providers. There will be no exemptions.

13.8.7 In my opinion this approach is entirely right.

13.8.8 The Islands have also, however, been concerned to ensure appropriate professional disciplines for members of the professions. In this, too, they are in my opinion entirely right. As some recent cases have shown, professional practitioners are in a position to engage in, facilitate or turn a blind eye to disreputable activities not just when acting as Trust and company services providers but also when acting in their professional roles. Client accounts may sometimes be used to facilitate the transactions involved. Such activities would not necessarily be caught under the new proposals for regulation of service providers.

13.8.9 For lawyers:

- The Isle of Man has Law Society and Legal Practitioners Acts of long standing to support its Law Society and its statutory Advocates Disciplinary Tribunal. The Law Society has rules concerning the operation of Advocate accounts, which have to be audited to ensure compliance with the rules.

- Jersey too has a Law Society and Disciplinary Tribunal. Legislation is to be brought forward in the forthcoming session to improve the framework for the Law Society and give teeth to the Tribunal. This legislation will make enforceable the Law Society's present voluntary Code about client accounts and related matters.

- In Guernsey, the Royal Court directly regulates the activities of Advocates, with the help of Court rules stipulating how they must handle client accounts. English solicitors are subject to regulation by the Law Society in London.

13.8.10 For *accountants*, there is no corresponding legislation and no local regulation. But all the accountants in the Isle of Man and most of those in Jersey and Guernsey are regulated by the self-regulating accountancy bodies of the UK.

13.8.11 In my opinion, the Islands will be well-advised to follow the UK's lead in considering a framework for independent regulation of accountants.

13.8.12 In the UK, the Government is committed to publishing detailed proposals later this year for such a framework. It is intended that the new framework should apply to the entire accountancy profession. It will similarly apply, in principle at least, to members of the UK professional bodies operating in the Islands (though not to any other accountants practising there).

13.8.13 The Islands will, I believe, do well to see whether the new framework, when it appears, fully meets the particular requirements of their finance centres, and to consider how the new regime, or something similar, could best be applied, on a comprehensive basis, in the Islands.

13.8.14 For both *lawyers and accountants*, the regimes for professional regulation need in my opinion to apply comprehensively to all practitioners practising in the Islands.

13.8.15 A key objective should be to make it as difficult as possible for anyone providing legal or accountancy services to engage in, facilitate or acquiesce in disreputable activity of any kind, either by the providing firm or by its clients.

13.8.16 The regulatory regimes need to include rules or enforceable codes for handling client accounts. These in turn need to cover not only the protection of client monies but also vetting of their provenance.

13.8.17 Also important, from the client's point of view, will be the requirements for professional indemnity and employee fidelity insurance.

**BOX 13.1-Sketch of Overarching Legislation to Register and Regulate Trust and Company Service Providers**

- The Financial Services or Supervision Commissions (FSCs) would be tasked to act as licensors and regulators of Trust and Corporate Service providers and to publish the names and addresses of licensed providers in a public Register.

- All persons, partnerships or companies offering trustee or other Trust services or company formation, selling, secretary, administration and Director services by way of a business, and any others defined in an updatable Schedule, would be required to apply to the FSCs for licensing as providers of the services in question.

- Only suitably licensed providers would be allowed to form Trusts and companies.

- In deciding whether to license providers, the FSC would be obliged to satisfy itself that the applicants were fit and proper in terms of integrity, solvency, competence, technical support and track record.

- The FSC would be obliged to draw up, promulgate and update, after consulting providers, Codes of Conduct for Trust, Company and Director services, and for any other necessary services.

- Registered providers of the various services would be obliged to comply with the relevant Codes. Some elements in them might be given specific statutory effect.

- The FSC would have powers:

  (a) to inspect and obtain information from providers for purposes of enforcement;
  (b) to name, warn, [fine] and/or remove from the Register providers who cease to be fit and proper or fail to comply with the relevant Codes of Conduct;
  (c) to approve compliance auditors;
  (d) to bring civil proceedings to enforce any aspect of the regulatory system.

- The providers would be required to submit to the FSC:

  (a) annual returns, including an audited compliance return and audited accounts;
  (b) ad hoc reports of changes in key personnel and/or legal actions against the provider or its Trusts or companies;
  (c) annual licence fees.

- The providers might also be required to maintain adequate levels of working capital, professional indemnity and employee fidelity insurance and professional staff, and to keep client funds separate from the providers' own funds.

- It would be an offence:

  (a) to act as a provider of the relevant services without registration, or
  (b) knowingly to deceive or mislead customers, or
  (c) knowingly to deceive, mislead or obstruct the Regulator.

**BOX 13.2-Corporate Service Providers: Illustrative Sketch for a Code of Conduct**

Corporate Service Providers are required:

- to promote the objectives of the Code, which are:

  to ensure the highest standards of integrity and professionalism in the service of clients,
  to prevent criminal or regulatory abuse, and
  to maintain and enhance the reputation of the Island;

- to act at all times with honesty and integrity and apply the "four eyes" principle;

- to know their customer, including the identity of any beneficial owners of more than 20 per cent of the worth of the company;

- to know and have regular contact with Directors and any "shadow" Directors on whose instructions they act;

- to establish the nature of the company's activities, to ensure that they are legal, and to ensure that they are informed of any changes in them;

- in the case of asset holding companies, to investigate the provenance of the assets and to ensure that they are not the proceeds of crime;

- to ensure that proposed company arrangements would be sustainable if publicly known and are not a device to conceal assets or put them beyond reach of creditors, tax authorities or other injured parties;

- to report any suspicions to the Island authorities;

- to co-operate with the Island authorities if they need information in the pursuit of enquiries into possible criminal behaviour or breach of regulation;
- apart from the above disclosures, to keep the client's affairs confidential;
- if they are providing Directors for a Company, to ensure that the Directors are fit and proper persons who can be relied on to act in accordance with the Code of Conduct for Directors;
- to ensure that the funds of individual asset holding companies are totally segregated from each other and from the provider's and custodian's own funds;
- to have a written client's agreement with the Directors, the shadow Directors and the beneficial owners (if different);
- to charge a reasonable level of fees, in accordance with industry guidelines;
- to ensure that annual accounts are prepared and submitted for all their companies, including a statement of provider fees charged,
- to ensure that the accounts are independently audited if the assets exceed 500,000;
- to keep records, files, minutes of meetings and details of post received by the company;
- to deploy sufficient staff with the required references, skills, experience and training to look after the Company's affairs;
- to apply proper internal controls including the four-eyes principle;
- to maintain adequate levels of working capital and Professional Indemnity and Employee Fidelity Insurance and to let clients know in appropriate terms about these;
- to avoid conflicts of interest;
- to manage transfers of clients in accordance with procedures defined by law or by the FSC;
- to avoid publicity or other material which would bring the Island into disrepute;
- to record, investigate and as appropriate act on complaints;
- to have an independent annual audit of their compliance with the legislation and the Code;
- to co-operate fully with the FSC and in particular:

    (a) to pay the annual registration fees,
    (b) to ensure that their companies are properly registered and make the proper returns to the Companies registry,
    (c) to submit the provider's own annual audited accounts,
    (d) to submit the annual compliance audit,
    (e) to submit such other information as the FSC may require, and
    (f) to co-operate in disciplinary and licence revocation procedures.

**14.6 Delays and lacunas in existing legislation**

14.6.1 The Islands have generally followed UK models of criminal as well as commercial legislation, sometimes with a considerable time-lag.

14.6.2 In my opinion, following UK models is a sensible approach. The Islands do not have skilled resources for law preparation and drafting on a scale which would enable them to re-invent every wheel.

14.6.3 The principal elements in the UK's legislative arsenal for combating financial crime and money laundering are the Acts of Parliament relating to

fraud
theft
extradition
proceeds of drug-trafficking and terrorist crimes
all crimes money laundering
police and criminal evidence and
international co-operation.

Also relevant in some cases are the UK's Mutual Legal Assistance Treaties with most of the other larger countries.

14.6.4 All the Islands now either have all these (or similar) elements in place or are well on the way to having them. In Jersey and Guernsey, however, as also in the British Overseas Territories, there have sometimes been delays of several years before they have followed the UK's lead. In many cases these delays would preferably, in my opinion, have been avoided.

14.6.5 The missing elements in the present legislative arsenals of Jersey and Guernsey may still be still inhibiting the authorities there from co-operating with other jurisdictions to the fullest extent in the pursuit of crime. It is clearly important, therefore, that that there should be no further slippage in the timetables for enacting these elements.

14.6.6 The present position in each of the Islands, compared with the UK models, is as follows.

*(a) Isle of Man*

14.6.7 The Isle of Man now has all the main elements in place, including a *Criminal Justice (Money Laundering Offences) Act, 1998, a Police Powers and Procedures Act, 1998 and Criminal Justice Acts, 1990 and 1991*, dealing with international co-operation. The Island section gives the full list. The only small omissions, compared with the UK legislation, are certain additional provisions made in the UK's Proceeds of Crime Act 1995, notably a provision enabling the Court to assume, when ordering confiscation of the assets of a defendant with two or more convictions in the previous 6 years, that the assets are proceeds of crime. The Isle of Man authorities are planning shortly to bring in a similar provision.

*(b) Jersey*

14.6.8 Jersey has not hitherto had *PACE* or *International Co-operation* Laws. In the absence of these, the Jersey authorities do not have powers to obtain information and evidence, or to assist overseas authorities at the investigation stage, except in cases related to drugs, terrorism, insider dealing and serious or complex frauds. The authorities intend, however, to have these laws in place by the autumn of 1999.

14.6.9 Jersey's All Crimes *Money Laundering* legislation is due to be enacted in the autumn. As in Guernsey, the authorities' powers to search, seize, restrain and confiscate will be limited until the Law is in force. Their suspicious transaction reporting system, too, will be limited in the meantime to the proceeds of suspected offences related to drugs and

terrorism.

*(c) Guernsey*

14.6.10 The Guernsey authorities propose to have an *International Co-operation* Law and the relevant elements of a PACE Law in place by the autumn of 1999. In the meantime, the powers to help overseas authorities are, as in Jersey, incomplete.

14.6.11 Guernsey's *All Crimes Money Laundering* Law is due to be enacted late in 1998. The authorities already have in place an all crimes suspicious transaction reporting system but will not have comprehensive powers to search, seize, restrain and confiscate until the new law is in force.

**14.7 Improving the legislative arsenals**

14.7.1 There are several areas, both in the UK and in the Islands, where the present legislation and international agreements might be improved so as to strengthen the hands of the authorities in the pursuit of financial crime and money laundering,

*(a) A general law on co-operation*

14.7.2 As the above discussion has indicated, the legislation enabling the UK and Island authorities to counter financial crime and money laundering and to assist overseas authorities has grown incrementally over the past 15 years.

14.7.3 The result is that the authorities in each jurisdiction have differing powers, circumscribed in a variety of different ways, in relation to differing kinds of offence, including some choices as to which piece of legislation they rely on in particular cases. The regimes differ as between drugs, terrorism, fraud, corruption, tax and money laundering cases in ways that have no obvious rationale.

14.7.4 There is no simple answer to the simple question: "How far are you able to co-operate with overseas authorities in the pursuit of crime?' 14.7.5 There are similar differences in relation to co-operation between regulators and tax authorities.

14.7.6 For law enforcement officers, regulators, tax officials and other professional practitioners alike, the variety of powers is unhelpful. There may therefore be a case for considering a single, general law on co-operation, along the lines sketched in Box 14.1, to replace the existing proliferation of tightly drawn provisions.

14.7.7 Such a law might empower the authorities of the home jurisdiction to investigate, obtain evidence and restrain assets, both on their own account and in response to requests from the authorities in other Jurisdictions, in relation to *all* criminal and civil cases.

14.7.8 As in much existing legislation on regulatory co-operation, the powers might be available irrespective of whether the crimes or regulatory breaches would also be crimes or breaches in the home jurisdiction.

14.7.9 The authorities would, however, retain the right to decline requests from overseas authorities where there were good reasons. The requesting authorities might, for example, be unable or unwilling to do for the home jurisdiction, or for themselves domestically, what they are asking the home jurisdiction to do. Or there might be wider considerations of public policy or human rights.

14.7.10 If the UK should think it right to adopt a simple general law along these lines, which might offer a useful standard for international practice, I hope that the Islands would be willing to follow suit.

14.7.11 It may well be that, for one reason or another, such a law would not be practicable or convenient. If so, however, a reasonable aim would be to amend existing laws over time to produce the same effect.

*(b) Information "gateways"*

14.7.12 If the authorities inside a Jurisdiction are to be successful in the pursuit of crime, they need to be able to share information with each other.

14.7.13 In both the UK and the Islands, the most important lacuna seems to be the inability of the Tax authorities to supply information to other authorities, or vice versa, even in cases where it appears that a crime (including a fiscal crime) may have taken place. Such information is potentially invaluable in the pursuit of crime. Only criminals benefit from the absence of a gateway.

14.7.14 If the UK is able to introduce such a gateway, therefore, I hope that the Islands will be willing to follow suit. It would of course continue to be necessary to pass on information received from overseas authorities only to the extent that the latter authorities were content for this to happen.

14.7.15 There may likewise be scope for improved gateways between regulatory bodies and public authorities. In this case, the EU Banking Directives limit the use that can be made of information exchanged between Jurisdictions.

*(c) Jurisdiction issues*

14.7.16 With the increasing internationalisation of criminal activity, and the increasing tendency to launder the proceeds of crime by transfers between different jurisdictions, the problem of which country should have jurisdiction in particular cases has become common.

14.7.17 Especially serious, perhaps, are the cases where no country is willing to take on the task of prosecuting criminals who clearly ought to be prosecuted. In the course of my researches and consultations I came across several such cases.

14.7.18 It is easy to see how such problems arise. If a company suspected of criminal activity or money laundering turns out to be registered in the Caribbean, with UK and American principals, a Swiss company agent and administrator, a headquarters office in the Channel Islands and a bank account in the Isle of Man, which of the centres concerned should take the lead in prosecuting? The danger is that none of them will. In that case, the criminal will be encouraged to develop further criminal activities along similar lines.

14.7.19 The problem may have further dimensions as well. The criminal activity may involve civil regulatory as well as criminal offences. The Jurisdictions concerned may have different kinds of law and investigation systems.

14.7.20 Neither the Islands nor the UK can solve these problems on their own. The solution may lie, partly at least, in an international agreement, perhaps under the aegis of the FATF, for the rules of engagement. Such an agreement might, for example:

- put the onus on the country of residence of the principal defendant to prosecute if other jurisdictions are unwilling to do so; and/or

- encourage individual countries to provide in their domestic legislation (where there would otherwise be a reticence to assume jurisdiction) that their Courts may have jurisdiction if any substantive element of an offence has been committed in the home jurisdiction (not just the last element).

14.7.21 The UK has provisions in the Criminal Justice Act 1993, unfortunately not yet implemented, which would enable UK Courts to hear cases of certain kinds where any element in an offence has been committed in the UK. The Guernsey authorities are proposing similar legislation. Meanwhile the Privy Council and the Court of Appeal in England appear to have responded to the increasingly international nature of many crimes by moving in the same direction and assuming jurisdiction if there is a reasonable connection with the UK.

*(d) Double Taxation Agreements (DTAs)*

14.7.22 With the removal of exchange controls and continuing improvements in the technologies for money transmission, the evasion of taxes through false booking of profits, bogus international transactions and non-reporting appears to be a problem of major proportions for virtually all jurisdictions.

14.7.23 As the EU member states have recognised in the EC Mutual Assistance Directive of 1977, the exchange of information between tax authorities is one important means for combating such evasion. The EU, the OECD and the G7 have all re-emphasised this in recent times and have underlined the need to address problems caused by restricted access to banking information. In this as in other areas, progress would best be achieved through international initiatives applying to all countries.

14.7.24 Each of the Islands has a Double Taxation Agreement with the UK which includes provisions for exchanging information. These agreements have a number of drawbacks, including a provision whereby information exchanged under the Agreements may not be used in evidence.

14.7.25 It seems clear that the present DTAs, which date from the 1950s, should now be replaced by *either*

- modern DTAs, based on the OECD model, or
- modern Exchange of Information Agreements (EIAs), based on the 1977 EC Mutual Assistance Directive and the Tax Information Exchange Agreements between the US and a number of Caribbean territories.

14.7.26 Either way, the information exchanged should preferably cover on request, spontaneous, automatic and personal information, as defined in the EC Directive. The coverage should preferably be as comprehensive as possible so as to strengthen the authorities' ability to combat crime. The authorities should be prepared, moreover, to give assistance even in cases where they themselves have no interest in the tax obligation.

## 14.8 Achievements

14.8.1 In the combating of financial as well as other crime, prevention and deterrence are clearly of the highest importance. And these in turn depend not just on detecting and convicting criminals and removing their ability to operate (for example through prison sentences or de-licensing) but also on depriving them of their gains and taking the profits out of crime. As one offender famously said:

"I'm not bothered how long they give me so long as they don't take away all the [expletive deleted] money".

14.8.2 In terms of taking the profits out of crime, few countries have so far been successful. The UK is no exception. Despite some successes, especially in the areas of drug trafficking and indirect taxes, amounts recovered are barely significant in relation to the scale of the problem. The US authorities have been more successful.

14.8.3 The experts seem agreed that the sums of money laundered through London alone each year amount to many billions of pounds, possibly more than 100 billion. In no recent year, however, have the confiscation orders issued under the UK's Drug Trafficking legislation amounted to more than 30 million. The amounts actually recovered, moreover, have typically been around one-third of these sums, with variations from year to year. Recoveries under the legislation relating to other crimes have so far been smaller still.

14.8.4 The Islands, for their part, have all had considerable successes, notably in individual drug trafficking cases. The US Agencies have commended them for assistance given. In relation to the likely scale of the problem, however, the Islands too, like the UK and most other countries, may not be doing much more than scratching the surface.

14.8.5 In the field of tax evasion, the position looks similarly problematic. A recent calculation suggests that tax evasion and avoidance in the UK could be running at an annual rate of at least 25 billion, compared with special compliance recoveries by the Inland Revenue and Customs combined of around 2.5 billion (Martyn Bridges, Journal of Financial Crime, Vol 4, No2). In many cases, evasion techniques involve the use of offshore centres. That is why, as discussed above, good co-operation between tax authorities, including offshore tax authorities, is so important.

14.8.6 With regard to insider dealing offences, again, soaring trial costs have typically dwarfed the amounts recovered.

14.8.7 Disappointing as the record to date has been, it would in my opinion be wrong to conclude that the present legislation, intelligence and enforcement apparatus is wrongly conceived or incapable of delivering results. It must be exercising a major deterrent effect. Without it, the amount of financial crime and money laundering would doubtless be significantly greater. Many criminals in other fields are identified through financial intelligence. The system is, moreover,

fairly new. Even in the UK, the full effects will not be felt for another year or two.

14.8.8 That said, the battle against financial crime, including money laundering and tax offences, is not yet being convincingly won anywhere. The profits of crime are not being taken away. It will therefore be an important task for the authorities in the UK and the Islands, as in other countries, to consider what more can be done, in terms of legislation, systems and practices.

### 14.9 Possible measures to take the profits out of crime

14.9.1 With regard to legislation and the law, there are four areas, all potentially important, which could have a significant impact in taking the profits out of crime and disrupting the schemes of criminals. In the first and third of these, it would be for the UK to take the lead and the Islands to follow. In the fourth, the Islands are already taking the lead.

*(a) Unexplained life-styles*

14.9.2 In the United States, the authorities have powers to restrain the assets of people with unexplained life-styles until they have accounted for them. These powers have proved a highly effective, though often controversial, means of recovering or confiscating the proceeds of crime, especially tax evasion, and may explain the much higher rate of recoveries than in the UK.

14.9.3 In Ireland, too, the Courts now have power to restrain the assets of persons suspected of criminal activities until they have proved their innocence. Significant numbers of criminals are believed to have moved elsewhere as a result.

14.9.4 In the UK and the Islands, the authorities do not at present have similar powers. The closest (but not very close) approximation is the provision in the Proceeds of Crime Act 1995 whereby the Courts may now assume, when ordering confiscation of the assets of a defendant with two or more convictions in the previous 6 years, that the assets are proceeds of crime.

14.9.5 Reversing the traditional burdens of proof clearly raises major issues. The question is whether the need to combating crime effectively has now reached a point where traditional interpretations of the presumption of innocence need to be partially qualified without destroying the basic presumption.

14.9.6 If the UK authorities should decide to take powers to restrain assets, and reverse the burden of proof, in cases where people are seen to live beyond their visible means, I hope that the Island authorities will be willing to consider doing something similar.

*(b) Penalties*

14.9.7 There may be a case for much heavier financial penalties for financial crimes. The penalties in the Islands are similar to, or in some cases higher than, in the UK.

*(c) Use of civil law and locus*

14.9.8 In the UK, as in other Jurisdictions, the authorities have not generally succeeded in bringing criminal convictions for financial crime, such as fraud, corruption, insider dealing, money laundering and evasion of direct taxes, on a scale remotely proportionate to the scale of crimes committed. Even where criminals are convicted, moreover, the authorities have not so far been very successful in depriving them of the proceeds of their crimes.

14.9.9 As part of their response to the problem, the authorities make some use of civil as well as criminal law procedures when trying to recover proceeds of crime. The Tax authorities, for example, make some use of Mareva injunctions as well as criminal restraint procedures to pre-empt disposal of assets ahead of confiscations and recoveries. The Island authorities employ similar techniques.

14.9.10 There is, however, a school of thought which argues that, as in the United States, the tax and other prosecuting authorities should make much more extensive use of civil powers to take the profits out of crime and recover proceeds (see Barry Rider (ed), Money Laundering Control, Roundhall, Sweet and Maxwell, 1996, pp 26-27). Standards of proof are typically lower in civil cases, laws of evidence more relaxed, and procedures faster, not least for international co-operation. Civil forfeiture powers, moreover, can in principle be used in cases where defendants cannot be brought to Court (for example, because they are dead). Tax and regulatory authorities in the Isle of Man have had considerable success in use of such powers.

14.9.11 The authorities may sometimes have difficulty in establishing *locus standi* when using civil procedures for such purposes against criminal enterprises. In general only the victim has locus to sue. But these problems might be eased through new statutory provisions allowing the authorities concerned to bring civil law proceedings to freeze assets of those under suspicion and remove them from convicted offenders.

14.9.12 In both the UK and the Islands, the authorities may wish to consider these points.

14.9.13 Whether or not the authorities decide to extend the use of civil procedures in this way, and to make statutory provision as required for locus, the autonomous development of the civil law itself may powerfully reinforce the criminal provisions of the latest legislation in deterring financial crime and money laundering.

14.9.14 Recent civil law cases in the UK and the Isle of Man have increased the risks to professional service providers and advisers if they turn a blind eye and do nothing when they suspect wrongdoing (Barry Rider, ibid). It has now been fairly clearly established that professionals who have grounds for suspicion:

(i) are potentially liable if they turn a blind eye instead of investigating something which clearly should have been investigated *(AGIP (Africa) Ltd v Jackson, 1991)*; and

(ii) have a duty to identify and warn potential victims of wrongdoing *(Finers (a firm) v Miro, 1991)*.

14.9.15 Liquidators in particular would probably wish to bring suits for restitutions against professionals who have turned a blind eye or remained inactive in such circumstances.

14.9.16 In the light of these judgments, the potential civil liabilities of professional advisers and service providers who turn a blind eye to clear cases of money laundering or other financial crimes must be on a scale to dwarf the penalties under the new criminal legislation for failure to report suspicions. The requirement in the criminal legislation to report suspicions, moreover, makes it less likely in practice that oversight would be a convincing defence.

*(d) Licensing and disqualifying the service providers*

14.9.17 Another valuable element in strategies for preventing financial crime is the licensing, regulation and, as necessary, disqualification of the professional service providers, Trust companies, company directors and administrators, agents and advisers who are potentially facilitators of such crime.

14.9.18 As discussed in Chapter 13 such providers, if not fit and proper, risk bringing finance centres into disrepute, either by introducing and condoning bad business or by defrauding or otherwise letting down their customers. The ability to put disreputable, dubious or incompetent providers out of business is therefore crucial.

14.9.19 A further reason for bringing all who provide such services within the regulatory boundary is that they are well placed to know about disreputable activities masked by company and Trust vehicles.

14.9.20 From this point of view, too, therefore, the Island authorities seem to me to be right to extend the regulatory boundary, as they propose to do, to include Trust and company service providers and to ensure effective regulation of lawyers and accountants.

14.9.21 If this policy is combined with the measures discussed earlier in this Chapter and those discussed in earlier Chapters for effective enforcement of regulation and improved regimes for companies and Trusts, the Islands will, I believe, have an outstandingly good total apparatus for preventing , deterring and combating financial crime and money laundering.

14.9.22 The UK, for its part, does not regulate Trust or company service providers. Although many of the individual providers are solicitors and accountants who are self-regulated by their own professional bodies, their conduct of Trust and company business as such is not regulated. Service providers who are not solicitors or accountants are mostly unregulated by any public or professional body.

14.9.23 Chapter 12 commended the case for licensing and regulating Trust services providers in the UK as well.

14.9.24 With regard to company services providers, the company sector in the UK is so different from that in the Islands, and the part played by service providers so much smaller, that it is not clear how regulation of such providers would work in practice and how much it would achieve. I hope, however, that the UK authorities will watch carefully the progress of the Islands' schemes with a view to assessing what lessons there may be for the UK.

### 14.10 Tax avoidance and "harmful tax competition"

14.10.1 This Chapter and the two succeeding Chapters make frequent references to tax fraud and evasion as being a significant element in the portfolio of criminal behaviour with which all finance centres have to contend.

14.10.2 There is a separate set of issues, mentioned in Chapters 2 and 10, concerning (legal) tax avoidance by the Islands' customers. The G7, the OECD and the EU have all been discussing the issue of "harmful tax competition" through low levels of tax, the absence of certain taxes, special corporate tax vehicles and the lack of exchange of information between tax authorities.

14.10.3 The Island authorities have argued with force that the issues involved in harmful tax competition are far from simple or straight forward. They have made known, rightly in my view, that they wish to play a full and constructive part, through whatever channels are available, in the global discussions.

14.10.4 Although there are plenty of artificial tax schemes and structures where the distinction between (legal) tax avoidance and (illegal) tax evasion becomes blurred, the basic distinction remains valid. The present report does not need, therefore, to discuss the issues of legal avoidance or harmful competition, which anyway lie outside its terms of reference.

### BOX 14.1-General Law on International Co-operation: an Illustrative Sketch

*1. If another Jurisdiction requests assistance and confirms that it is investigating, trying or punishing criminal behaviour or infringement of its own laws or regulations, suspected or actual, the authorities of the home Jurisdiction shall at their discretion:*

- *conduct investigations, obtain evidence and restrain assets, with help as necessary from the requesting Jurisdiction's authorities; and*
- *pass the results of the investigations and the evidence obtained to the requesting Jurisdiction, with any necessary restrictions as to the use to be made of them, and extradite suspects.*

*2. Such assistance shall be provided irrespective of whether the suspected or actual offence would also be an offence in the home Jurisdiction.*

*3. In deciding whether to exercise their discretion not to provide such assistance, the authorities of the home Jurisdiction shall satisfy themselves that one or more of the following reasons apply:*

*(a) the requesting Jurisdiction would not be able or willing to do the same itself inside its own borders;*

*(b) the requesting Jurisdiction would not be able or willing to give the same co-operation to the authorities of the home Jurisdiction;*

*(c) compliance with the request would be clearly against the public interest or risk causing a violation of human rights*.