Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda

Presented to Parliament by the Secretary of State for Foreign and Commonwealth Affairs and the Governments of Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands.

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Cm 4855-ii	Part 2 - Bermuda	16.85
Cm 4855-iii	Part 3 - The British Virgin Islands	18.50
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Contents

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Contents

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Contents

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Contents

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Contents

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Contents

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Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda — Anguilla

1 Executive summary

1.1 Introduction

This is one of six reports we have issued covering the Caribbean Overseas Territories and Bermuda. This report deals with Anguilla.

Anguilla is a British Overseas Territory 90 square kilometres in size. It is the most northerly of the Leeward Islands in the Eastern Caribbean. Anguilla was administered as a single federation with St Kitts and Nevis from 1958 to 1962 but sought separation in the 1960s. It became a British Dependent Territory in its own right in 1980. The estimated population of Anguilla is 11,915. Its GDP per capita in 1997 was US$ 7,383. Its estimated growth rate for 1998 was 7.1%.

Constitutionally, Anguilla is an internally-governing Overseas Territory. Government is enacted through a Governor appointed by the Crown, an elected House of Assembly and an Executive Council. The Governor retains responsibility for internal security, external affairs, defence, the public service and (importantly, in the context of this review) international financial services.

Anguilla recently experienced a year of political paralysis following a general election in 1999. During this time the House of Assembly did not meet and no legislation was passed. Whilst this problem has been resolved following fresh elections earlier this year, a legislative backlog still remains which is being dealt with.

1.2 Financial services in Anguilla

Anguilla has a small but growing offshore financial sector, although its main industry is tourism. The offshore financial sector is primarily focused upon the incorporation and management of companies.

As at 31 December 1999, there were 1,323 Companies Ordinance Companies (primarily conducting local business) and 1,742 International Business Companies ("IBCs") (conducting offshore business). There are also 78 companies registered under the Limited Liability Company Ordinance. Four limited partnerships have been registered.

Under the Company Management Ordinance 28 licences have been granted.

There are currently four domestic banks in Anguilla. Total asset size for the domestic sector is approximately $EC 740 million (approximately US$276 million). There are currently only two organisations licensed as offshore banks in Anguilla. One of these licence holders primarily undertakes limited merchant banking business and maintains a physical presence in Anguilla. The other is a major international bank which is also regulated by the Eastern Caribbean Central Bank ("ECCB") for its domestic banking activities. As part of an internal restructuring the latter licence holder's offshore activities are being reduced.

Anguilla also has a relatively small insurance industry dominated by the domestic sector. The total number of companies licensed is 17 domestic insurers and one offshore captive insurance company.

Other than the number of companies operating, there are no insurance statistics available.

There is no identified activity in the securities/investment business nor is there any identified mutual fund business.

As in most other jurisdictions, there is no requirement to register trusts in Anguilla. Accordingly the precise level of trust activity is unknown but is believed to comprise approximately 43 trusts.

Only one licence holder undertakes trust business in Anguilla.

1.3 Financial services regulation

Under the constitution the Governor has responsibility for international financial services. Responsibility for day-to-day regulation is delegated to Inspectors appointed under the various pieces of financial service legislation. The Inspector in this context is the Director of the Financial Services Department ("FSD") which forms part of the Ministry of Finance. The supervision of domestic banks is undertaken by the ECCB of which Anguilla is a member jurisdiction.

There is legislation in place covering the regulation of banking (both domestic and offshore), domestic insurance, company managers and trust service providers. There is no specific regulatory legislation relating to offshore insurance, securities/investment business or mutual funds.

Given that the Bills were tabled at the time of our visits, we have considered them for the purposes of this Report and we comment on their effect. However, the timing of their enactment (they were passed by the House of Assembly and assented to by the Governor on 31 July 2000) means that we have not had an opportunity to review the final Acts and have relied upon information regarding their final content provided by the Government of Anguilla.

1.4 **Summary of principal findings**

1.4.1 **Regulatory authority**

Overall the FSD is a well-run regulatory department with an experienced Director and Registrar of Companies. As a Government department, without the direct power to make licensing and other regulatory decisions, the FSD lacks the necessary operational independence to meet international standards. We therefore consider that the FSD should become operationally independent.

We also consider that the current resourcing in the FSD is insufficient to fully perform its regulatory functions. We understand that further recruitment is in progress.

1.4.2 **Banking**

The responsibility for licensing and supervising banks in Anguilla is undertaken by two regulators. In the case of domestic banks, as stated above, this is the ECCB. Offshore banks (which are banks incorporated in Anguilla but whose activities are conducted with non-residents in currencies other than the EC dollar) are regulated and supervised by the Inspector of Trust Companies and Offshore Banking.

The remit of our review does not include a detailed analysis of the ECCB, as it does not come within the jurisdiction of Anguilla. Our review has therefore comprised consideration of the relevant legislation and discussions with the ECCB.

In respect of offshore banks, the fact that there is effectively only one licensed offshore bank in Anguilla means that the introduction of a substantial regulatory structure is neither required nor practical. As further licences are granted, a more formalised and documented regulatory structure will be required. The FSD agree with this.

The former Offshore Banks and Trust Companies Ordinance did not permit the Inspector to access information relating to individual depositors when conducting an on-site inspection. Our draft report recommended that this should be changed. Since the date of our review new legislation has been enacted which grants regulatory access to client files.

We also raise the possibility of transferring the regulatory supervision of offshore banks to the ECCB. Whilst this is not required to enable sound banking supervision of the existing sector we do consider it to be a possible approach and one that could be considered if the offshore banking sector in Anguilla was to develop.

1.4.3 **Insurance**

Existing insurance legislation was designed for domestic insurance only. It dates back to 1968 and does not meet modern requirements. In the light of this we agree with the FSD that until a new insurance law meeting international standards is introduced, approved and properly implemented, Anguilla should not accept any applications from persons wishing to establish offshore insurance companies.

In order to allow more appropriate monitoring of the domestic insurance market we also recommend that a facility for recording industry information is introduced, and that reinsurance programmes for domestic carriers are reviewed and approved annually. The FSD has confirmed to us that new reporting forms have been sent to all insurers for completion to reflect their 1999 insurance activity.

1.4.4 **Securities/investments**

The ECCB is currently preparing draft legislation covering the activities of securities and investment businesses. Once finalised, it is proposed that the legislation will be implemented in all eight ECCB member jurisdictions.

There are, however, potentially conflicting constitutional issues concerning the role of the ECCB and that of the Governor of

Anguilla as the Governor has overall responsibility for international financial services in Anguilla. These should be addressed before the legislation is brought into force.

1.4.5 **Mutual funds**

As stated above, there is no legislation currently in place relating to mutual funds. However, the ECCB proposes that its draft securities law will encompass the regulation and supervision of mutual funds.

We agree that a possible method for developing a legislative and regulatory structure would be through this draft Securities Act. As with securities/investment business any potential constitutional issues should be addressed prior to doing this.

1.4.6 **Stock Exchange**

There is currently no Stock Exchange in Anguilla and consequently no activity. However, an Eastern Caribbean Securities Exchange ("ECSE") is in the process of development and this Exchange will cover Anguilla together with the other seven members of the ECCB.

The lack of finalised legislation and published regulations limits a full and effective evaluation of the proposals against international standards and good practice.

As the ECSE is to be private sector owned and controlled and will operate as both a business and a Self-Regulatory Organisation ("SRO"), we consider that strong safeguards should be introduced by the proposed Eastern Caribbean Securities Commission ("ECSC") to ensure effective regulatory oversight. Furthermore, whilst it is proposed that regulation will be formally carried out by the ECSC, the actual obligation to do this is due to be assigned by the ECSC to the ECCB.

In our view for this arrangement to meet international standards, the ECCB should demonstrate that it has sufficiently trained and experienced resources to fulfil its role. The ECSC should also have the necessary resources to confirm that the ECCB is fulfilling its assigned obligations effectively.

1.4.7 **Companies**

From our review it is clear that the Companies Ordinance ("CO"), which was enacted in 1994 and amended in 1998 and again in 2000 is a modern and comprehensive piece of legislation containing most of the features that we would expect to find. The legislation is supported by a modern Companies Registry. We are of the opinion that the CO is broadly compliant with established good practice. However, given the scope set out in the TOR, there are specific areas that we have not reviewed that we consider should be subject to a more thorough review. These are referred to in our report but include:

- the issue of prospectuses; and
- insolvency.

Although the International Business Company Ordinance ("IBC Ordinance") is similar to legislation found in a number of other jurisdictions, it too was substantially amended in 1998 and, again in 2000 and is in line with many good practice standards. In particular, the IBC Ordinance was amended:

- to provide that a person disqualified to act as a director of a CO company may not act as a director of an IBC; and
- to provide the Registrar with the power to apply to the Court for the appointment of an inspector.

Nevertheless, there remain some deficiencies with the IBC Ordinance which are identified in this Report. Consequently, we do not consider that it fully complies with the good practice standards.

The LLC Ordinance was also substantially amended in 1998 and, again in 2000 and brought into line with many good practice standards.

We have made a number of recommendations intended to reduce the potential for companies to be used for money laundering, fraud or other illegal purposes. These are:

- the "immobilisation" of bearer shares;
- that the names of directors should form part of the publicly available information held at the companies registry; and

- that the enforcement powers under the Companies Act and the IBC Ordinance are increased to include the ability of the Registrar to petition the courts to wind up a company in the public interest.

The issue of bearer shares is particularly important. Measures should be introduced whereby:

- the regulator can, where necessary, find out the ownership (through the licence holder);
- there are adequate legal powers to require this information to be kept and disclosed; and
- in appropriate cases it can then be passed, as indeed can other company information not concerned with bearer shares, to regulators in other jurisdictions, through "gateways".

1.4.8 **Company service providers**

Anguilla has in place a number of regulatory provisions relating to the supervision of those engaged in company service provision. We consider this to be a positive element of Anguilla's regulatory environment. These provisions are supported by the additional requirements imposed through the introduction of the ACORN company registration system and together they achieve a significant number of the criteria set down by the Guidance Notes.

In particular, with the exception of the minor issues detailed in the Report we consider that ACORN enhances rather than detracts from the regulatory environment. We certainly do not consider that it poses any additional risks regarding the abuse of companies to those experienced in other offshore centres without this online facility.

The Anguilla Government was aware that some improvement was required and sought to address this through the CMA2000. It is our view that, the new Act achieves further compliance with the Guidance Notes.

We are however concerned that the new CMA contains restrictions on the ability of the regulator to share client specific information with regulators in another jurisdiction without a court order. We do not consider that this is in line with good practice and recommend that this restriction is removed.

1.4.9 **Partnerships**

We are of the view that, as a result of the amendments to the Limited Partnership Ordinance, Anguilla meets in many respects the good practice standards set out in the Guidance Notes.

However we consider that a limited partnership should be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership.

1.4.10 **Trusts**

Trust legislation in Anguilla is similar to the trust legislation in a number of other jurisdictions. In general, we do not consider that there are any features of the Trust Ordinance or the Fraudulent Dispositions Ordinance that are likely to lead to trust structures in Anguilla being considered particularly attractive to those wishing to engage in criminal conduct.

As a general point, rather than one specific to Anguilla, we recommend that legislation is amended to prevent the use of so-called "flee" clauses in trust documents to frustrate legitimate creditors or to restrict regulatory or criminal investigation.

1.4.11 **Trust service providers**

We consider that, as there is only one active licence holder, the requirement for a detailed and formalised regulatory regime is unnecessary as the same standards of regulatory supervision can be achieved via less formal routes.

1.4.12 **International co-operation**

Anguilla seeks to co-operate with regulators and criminal authorities in other jurisdictions in respect of legitimate requests. To achieve this it has a number of gateways for such co-operation and also has a mutual legal assistance treaty with the USA.

Nevertheless until very recently, Anguilla lacked the full range of legislation necessary to enable full international co-operation to occur. However the Criminal Justice (International Co-operation) (Anguilla) Act is now in place and this significantly increases Anguilla's capability to co-operate.

Additionally, Anguilla does not currently have the capability to co-operate with other regulators to the equivalent level of the

Guidance Notes. We are aware, however that this deficiency is being addressed and legislation to provide this equivalence is being developed.

1.4.13 **Anti-money laundering**

At the time of our review Anguilla was the only one of the Overseas Territories not to have in place "all crimes" anti-money laundering legislation. As in the case of international co-operation, advanced drafts of the legislation were in place but the legislation itself had not been passed. This legislation has now been enacted.

Furthermore, it was notable that no suspicious transaction has ever been reported. Also at the time of our visit a number of other deficiencies needed to be addressed as a matter of urgency as they undermined the ability of the legislation to be effectively implemented. We are pleased to note that since our review:

- regulations and guidance notes to support the primary legislation have been finalised and are now ready to be issued; and
- the Money Laundering Reporting Authority Act has been enacted and the members of the Reporting Authority have been appointed. Furthermore, specific officers who will be responsible for investigation of money laundering cases have been identified.

1.5 **Conclusion**

In general, Anguilla has many of the features necessary to be considered a well-regulated jurisdiction. Of particular note is the development of the ACORN company registration system and the operation of the company registry in general which we consider, with some comparatively minor enhancements, to be an example of how on-line registration can be developed in a well-regulated manner.

Another area of note has been the willingness of Anguilla to incorporate suggested changes in its legislation. A number of recommendations made in earlier drafts of our report have already been actioned in this way and legislation rectifying areas of concern has been enacted. We consider such an approach to be highly positive. Nevertheless Anguilla will now need to ensure the effective implementation of the new legislation.

We welcome your comments on this site.

Prepared 27 October 2000

2 Methodology

2.1 Introduction

2.1.1 The UK Government White Paper

The UK Government White Paper "Partnership for Progress and Prosperity: Britain and the Overseas Territories" ("the White Paper")[1] was presented to the UK Parliament in March 1999.

The White Paper recognised that the international financial service industry has grown dramatically in recent decades and that a significant number of the Overseas Territories have developed successful offshore financial sectors and so diversified their economies. The White Paper further commented that it was essential for the future of the financial services sector that the Overseas Territories reputation for honest administration and probity be preserved and enhanced.

The White Paper stated that development of sizeable financial sectors brings risk of abuse and that as markets develop and techniques for laundering money, fraud, tax evasion and regulatory abuse evolve so financial regulatory systems must improve, be updated and be responsive to ever tighter international standards.

The White Paper further stated that the Caribbean Overseas Territories in particular are a potential target for money launderers because of their offshore financial business, their proximity to major drug producing and consuming countries and, in some cases, their inadequate standard of regulation and strict confidentiality rules. The White Paper also stated that the Territories are also at risk from attempted fraud and that failure to tighten regulation could affect the stability of and confidence in financial markets. The White Paper emphasised the importance of the Overseas Territories meeting accepted international standards. To assess progress made in this area, it required an in-depth independent review to be undertaken by regulatory experts. This review was also to make recommendations as to how to deal with any issues outstanding.

2.1.2 Development of the review process

Following the publication of the White Paper, a Steering Committee was formed. This Committee comprised representatives of the Foreign and Commonwealth Office ("FCO"), the Treasury, the Financial Services Authority and the Governments of the Overseas Territories.

The Steering Committee approved the Terms of Reference ("TOR") for this review, together with Guidance Notes on international standards and good practice relating to the areas under review. We understand that the guidance on accepted international standards in financial regulation ("the Guidance Notes") contained within the TOR was arrived at following a process of detailed consultation and discussion between representatives of the Overseas Territories, the FCO, HM Treasury and the UK Financial Services Authority. These are attached in Appendix 1.

The Guidance Notes represent good practice. The Overseas Territories have therefore chosen to be assessed against standards which, in a number of areas (such as company and trust service provision), are not applied in a number of major centres. This approach demonstrates the commitment of the Overseas Territories in seeking to ensure that financial regulation in these jurisdictions will eventually meet high standards. As such they are providing a powerful role model to other offshore centres.

The Guidance Notes do not prescribe how particular standards should be achieved; rather, the Overseas Territories are left to decide for themselves how best to achieve the standards laid down in them.

On 20 December 1999 we were appointed by the FCO, acting on behalf of the Steering Committee, to undertake the review of financial regulation referred to above.

The review covers Anguilla, Bermuda, the British Virgin Islands ("BVI"), the Cayman Islands, Montserrat and the Turks & Caicos Islands ("TCI") (referred to collectively as the Overseas Territories). The White Paper covers a wider number of locations (such as Gibraltar) but this review is restricted to these six Overseas Territories.

The purpose of the review has been to assess the Overseas Territories' performance against international standards and good practice, and to make recommendations for improvement where any territory falls below those standards.

2.2 **Scope of the review**

The scope of the review was as follows:

In relation to the regulation of financial services activity

- List separately the type and composition of offshore financial services business in each Overseas Territory.
- Ascertain what legislation, regulations, rules, guidance, systems and procedures (statutory or otherwise) govern the regulation and supervision of the:

  - Banking sector

  - Insurance sector

  - Securities sector (including mutual funds and stock exchanges).

- Assess the monitoring, supervision and regulation of activity as well as the enforcement of rules, regulations and laws.
- Evaluate to what extent arrangements in the Overseas Territories meet the standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).
- Consider the adequacy of the system of supervision relative to the objectives of Overseas Territories' financial services regulation.
- Comment on the existence and adequacy of depositor and investor protection schemes.
- Determine whether further action is required by any territory in order to meet the standards set out in the Guidance Notes and prioritise recommendations.

In relation to the regulation of companies, partnerships and trusts

- Ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts.
- Detail the type of information available on the activities of companies, partnerships and trusts.
- Determine whether the regulatory mechanisms in place are sufficient to meet international standards.
- Consider whether further action is required by any Overseas Territory to meet the standards required and prioritise recommendations.

In respect of independent regulatory authorities

- Evaluate to what extent regulatory authorities comply with accepted international standards advocated principally by Basel, IOSCO, the Offshore Group of Banking Supervisors (OGBS) and IAIS.
- In particular, evaluate whether regulatory authorities are accountable, independent and free from business and political influence and properly staffed and budgeted for with an independent source of income.
- Determine whether the relevant authority is detached from the marketing of financial services and, where this is not so, assess any impact this may have on the ability of the regulatory authority to regulate the sector objectively.
- Assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; co-operate with requests for assistance from foreign authorities; enforce rules, regulations and laws by taking enforcement action; and the extent to which they can liaise with law enforcement authorities in the sharing of information.
- Consider which activities fall under the responsibility of the regulatory authority and whether the regulatory net covers all financial activities.

- Consider what legal advice is available to the authority and its effectiveness in helping the Overseas Territory's government to regulate the sectors.

In relation to international co-operation

- Evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of the Overseas Territory's law enforcement and regulatory authorities to co-operate with requests for assistance from foreign authorities.
- Ascertain what legal advice is available to regulatory and law enforcement authorities in the Overseas Territory, and determine effectiveness in helping the Overseas Territory's government to co-operate in these areas.
- Determine whether further action is required by any territory in any of these areas, and the relative priority of such action.
- Consider whether there are effective "gateways" provisions in place concerning co-operation between regulatory authorities as well as the Overseas Territory's powers to obtain information, including by compulsion, the ability of foreign authorities to take voluntary testimony from the Overseas Territory's residents and the Overseas Territory's ability to safeguard the confidentiality of information provided by foreign counterparts. In addition, determine whether there are any provisions governing conditions under which information may be passed to overseas jurisdictions and whether effective memoranda of understanding exist (where required to underpin co-operation).
- Assess the extent to which the Overseas Territory's law enforcement authorities can obtain evidence on behalf of their foreign counterparts and exercise other available mutual legal assistance powers, stating the mechanisms and the Overseas Territory's authorities involved.
- Assess the Overseas Territory's ability to assist foreign authorities in tracing, freezing and confiscating proceeds even if the underlying conduct takes place outside the Overseas Territory.
- Assess the effectiveness of mutual legal assistance treaties with the USA where applicable and provide the basic volume of requests for assistance made and received.
- Assess powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted.
- Assess the ability to safeguard the confidentiality of information provided to Overseas Territory's law enforcement authorities.
- Assess whether effective memoranda of understanding exist, where required, to underpin co-operation.
- Evaluate whether there is effective co-operation between law enforcement authorities and financial regulators both domestically and abroad.
- Consider the ability of the Overseas Territories' regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

In relation to measures to combat money laundering

- Establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the Overseas Territories to combat money laundering and types of offences caught by the legislation.
- Determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.
- Evaluate the effectiveness and adequacy of those arrangements in terms of how they meet the applicable international standards.
- Provide specific consideration to the offences considered predicate for the purposes of money laundering legislation.

- Consider whether the Overseas Territories' have regulatory legislation in addition to the principal money laundering offences and, if not, whether guidelines and/or codes of practice exist (statutory or otherwise).
- Consider the Overseas Territories' systems for reporting suspicious transactions and identifying customers, the institutions obliged to report, how reports are dealt with and within what timeframe.
- Consider how this information is disseminated and shared with foreign counterparts.
- Evaluate the ability of financial intelligence units or their equivalent to deal with suspicious transactions.
- Determine to what extent the Attorney-General's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws.

2.3 **Project governance**

2.3.1 **The Steering Committee**

The Steering Committee played a key role in setting the parameters for and guiding the conduct of the review by its involvement in:

- agreeing the TOR and benchmark standards to be applied by the review team prior to its appointment;
- offering guidance over the detailed review process through a series of Steering Committee meetings which took place at key stages in the review process; and
- agreeing the format and reviewing the content of this report and providing comment as appropriate.

The responsibility for the opinions expressed, is however, a matter for KPMG.

2.3.2 **The Strategic Team**

In undertaking the review, KPMG utilised a Strategic Team composed of former senior regulators from a number of different jurisdictions, as well as its own partners and staff. The involvement of these individuals enabled the assessment better to take into account how the standards are implemented in practice on an international basis.

Members of the Strategic Team have had significant involvement in the setting of international standards as well as their implementation. The team included a former Chairman of IOSCO's Technical Committee, the Director of Regulation at Lloyd's of London, a former Deputy Director of the United States Securities and Exchange Commission of International Affairs, a former executive Director of the Hong Kong Securities and Futures Commission and the former Chief Executive of the Isle of Man Financial Supervision Commission.

The external members of the Strategic Team provided advice and guidance to KPMG, particularly during the early stages of the project and through the initial drafting of this report. The role of the external members of the Strategic Team was advisory, however, and the analysis and recommendations in this report are the responsibility of KPMG.

2.3.3 **Responsibility for this report**

This report has been prepared by the UK firm of KPMG. Although we have associated firms in the Overseas Territories, they have not been involved in the preparation of this report, nor should any responsibility for any of the opinions in this report be attributed to them.

2.4 **Approach to the review**

2.4.1 **Structure of the report**

The individual sections of the report are generally divided into a number of parts, as follows:

- an introduction, giving a broad outline of the international standards and/or good practice against which our assessment is made;
- a description of the nature and scale of the activity in the jurisdiction;

- a factual assessment produced in conjunction with the Overseas Territory which has been formally confirmed by them as accurate; and
- a section covering the issues arising from our analysis, together with recommendations we consider appropriate to remedy any deficiencies identified.

2.4.2 **Benchmarks**

In determining the appropriate international standards and good practice we have, as instructed in the TOR, used the Guidance Notes.

In the areas of banking, insurance, securities/investments and stock exchanges there are established international standards by which compliance can be assessed. Similarly, with respect to anti-money laundering measures, the recommendations of the Financial Action Task Force and the Caribbean Financial Action Task Force provide benchmarks.

However, in other areas, such as the provision of company and trust services, there are no internationally accepted standards. The Guidance Notes have instead been based upon what has been agreed as good practice.

In accordance with the TOR we have, in conducting this review, taken due notice of the recommendations made in the recent Home Office report on the Review of Financial Regulations in the Crown Dependencies. However, the terms of reference for the two reviews are substantially different in that benchmark standards were not defined in the Home Office review and hence there was no requirement to make an assessment against them.

Accordingly, in framing our recommendations we have assessed compliance with the benchmark standards set out in the TOR.

2.4.3 **Phases of the review**

2.4.3.1 ***Legislative review***

At the outset of the review the Overseas Territories provided us with copies of relevant legislation and regulations.

2.4.3.2 ***Pre-visit questionnaires***

Prior to commencing our on-site reviews, we prepared a pre-visit questionnaire for completion by each of the Overseas Territories. The questionnaire covered the areas required by the TOR. A draft questionnaire was reviewed by the Steering Committee and their comments were incorporated prior to issue. Comments were also invited and received from other parties with experience in relevant areas, for example the FATF in respect of money laundering.

Following this consultation the questionnaire was issued and responses received from the Overseas Territories. These responses were analysed by us prior to the commencement of the on-site review.

2.4.3.3 ***On-site review programme***

The analysis of questionnaire responses was used to prepare a work programme for the on-site review. This mechanism was important in ensuring that the on-site stage of the work was completed to a consistent standard across all the Overseas Territories.

2.4.3.4 ***On-site review***

The on-site review was undertaken in March and April 2000. It comprised in excess of twenty-six man weeks in the Overseas Territories. A total of eight staff, together with two members of the Strategic Team, were deployed across the Overseas Territories. Each consultant was allocated a specific area for review in line with their sector specialism. Work was conducted in line with the on-site review programmes outlined above, adjusted where necessary for issues identified on-site.

2.4.3.5 ***Meetings with third parties***

As part of the review process we had extensive discussions and meetings with third parties (in the UK, the Overseas Territories and elsewhere) who had experience of, or an interest in, the jurisdictions under review. These third party discussions were particularly pertinent in the areas of international co-operation and anti-money laundering measures.

Meetings with the third parties referred to above included:

- The United States Securities and Exchange Commission ("SEC");
- The United States Department of Justice ("DoJ");
- Representatives of the Overseas Territories;
- The United States Federal Reserve;
- The White Collar Criminal Investigation Team ("WCCIT");
- The Overseas Territories Regional Criminal Intelligence System ("OTRCIS");
- The Financial Services Authority ("FSA");
- The National Criminal Intelligence Service ("NCIS"); and
- The Ontario Securities Commission ("OSC").

2.4.3.6 ***Findings from previous reviews***

Our review also considered the results of previous reviews of sectors of the various Overseas Territories. These included:

- the 1992/3 Bank of England "Report on the arrangements for the supervision of offshore banks", covering Anguilla, the BVI, Montserrat and the TCI;
- the CFATF mutual evaluation of Bermuda, the BVI, the Cayman Islands and the TCI; and
- the 1993 Sullivan Reports on the regulation of insurance in Anguilla, the BVI, the Cayman Islands, Montserrat and the TCI.

In addition to the above, we have used other information sources including promotional and advisory material issued by the Overseas Territories and others.

2.4.3.7 ***Reporting***

Whilst we have sought to give due credit for regulatory achievement wherever possible, it should be noted that our reports are phrased on an exceptions basis. We have identified issues and made recommendations in those areas where we consider they are required. The nature of our issues and recommendations tend to reflect the stage of regulatory development reached by the jurisdiction in question.

Those jurisdictions with more mature financial sectors and better developed regulation have tended to generate more detailed recommendations.

In those jurisdictions where we have identified a more significant lack of basic regulatory structures, our recommendations are, necessarily, focused on the major issues to be addressed. There will inevitably be many subsidiary issues which will need to be considered following action on those which are more fundamental. It is impossible to anticipate these until those more significant issues have been addressed.

2.4.3.8 ***Confirmation of factual accuracy and discussion of findings***

Following the on-site reviews, we issued initial draft reports in May 2000. We then visited each of the Overseas Territories over a two-week period at the end of May.

This second visit was designed to give the Overseas Territories the opportunity to comment on findings and confirm the factual accuracy of the initial draft reports. Comments received during the course of this visit were confirmed (where they related to issues of factual accuracy) and considered. Our draft reports were adjusted where the review team considered this to be appropriate.

Following these second on-site visits, further draft reports were prepared. These were issued on 17 July. They were also discussed with the Overseas Territories who (along with the Steering Committee) were again given an opportunity to comment. Written as well as oral comments were received from the Overseas Territories and others; all have been carefully considered.

The Overseas Territories have provided formal written confirmation of the factual accuracy of the relevant parts of our reports.

2.4.4 **Regulatory arbitrage**

Regulatory arbitrage is the selection of a jurisdiction of operation on the basis of the regulatory legislation and structure in place. Regulatory arbitrage tends to result in persons who, for their own reasons, wish to avoid regulation selecting less regulated jurisdictions. Consequently, less regulated jurisdictions often become a target for money launderers and fraudsters.

All the jurisdictions have expressed a commitment to achieve the required international standards in financial services regulation envisaged by the White Paper. We consider that it should be recognised that other offshore centres, not being part of the Caribbean Overseas Territories and Bermuda, who also provide financial services and who may be regarded as competitors of the Overseas Territories, may not share the same level of commitment.

To prevent the possibility of regulatory arbitrage, even on a short-term basis, the adoption of international standards should be seen as a global issue and not simply one of relevance to the Overseas Territories. Therefore, other jurisdictions should be encouraged to ensure that they introduce similar improvements and thereby facilitate a level playing field between jurisdictions.

The work of groups such as the Financial Stability Forum in raising global standards will be of importance in this area and should continue to receive strong support from both the UK and the Overseas Territories.

2.4.5 **Scope limitations and other related matters**

Our terms of reference do not provide for us to verify all the factual matters in this report, which would be a major and time consuming task. Instead, as agreed with the Steering Committee and set out in the TOR, we asked the Overseas Territories to provide us with information (including copies of relevant legislation) and to check various drafts of our reports for factual accuracy. This they have done. It should be appreciated that any further information not provided to us might alter our conclusions.

In a number of instances, sector information (for example total funds under management and analyses of a jurisdiction's main sources of business) is not collated by the jurisdiction and therefore was not available to us. In other cases available information is dated.

There was also, on occasion, a lack of available statistical information, particularly in relation to co-operation provided by the Overseas Territories to other jurisdictions. It appears that either this information is not available in a format that is retrievable to provide the statistics necessary, or it is not kept at all. The absence of such information has made certain comments on the level of co-operation provided by the Overseas Territories impossible to verify or refute. Recommendations to resolve this matter have been made in the report.

In the latter stages of our review Anguilla introduced a considerable body of new legislation. Given that the Bills were tabled at the time of our visits, we have considered them for the purposes of this Report and we comment on their effect. However, the timing of their enactment (they were passed by the House of Assembly and assented to by the Governor on 24 July 2000) means that we have not had an opportunity to review the final Acts and have relied upon information regarding their final content provided by the Government of Anguilla.

This report has been prepared for the sole purposes of a review of Financial Regulation in the Caribbean Overseas Territories and Bermuda for the Steering Committee comprising representations from the Foreign and Commonwealth Office, HM Treasury, Financial Services Authority and Governments of Bermuda, Cayman Islands and Anguilla ("the client"). It has been designed to meet the agreed requirement of the client and particular features of the engagement of KPMG determined by the client's needs at the time. This report should not therefore be regarded as suitable to be used or relied on by any person or organisation other than the client or for any other purpose or in any other context. Any person or organisation other than the client who chooses to rely on this report will do so at its own risk. KPMG will accept no responsibility or liability in respect of this report to any third party.

2.4.6 **Timescales**

Whilst we have noted areas where we consider action is required as a priority we have not set out specific timescales. We consider that the precise timescales are best determined bilaterally between the individual overseas territories and the Foreign and Commonwealth Office.

2.4.7 **Acknowledgements**

We are most grateful for the significant amount of time spent by representatives of the Overseas Territories, Her Majesty's Government and the other organisations whom we met.

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Prepared 27 October 2000

3 Regulatory authority

3.1 Introduction

As stated in the White Paper, a sound, transparent regulatory environment is necessary to maintain investor confidence and the reputation of the financial sector in a particular jurisdiction. This is only possible if the regulatory authority is, and is seen to be, independent.

In order to demonstrate this 'independence', the jurisdiction must be seen to meet international standards. These standards extend beyond simple independence to encompass such issues as resourcing and accountability. This theme is developed further below.

Our terms of reference cite four documents which provide specific details on what the international community expects from a regulatory authority. These documents are:

- Objectives and Principles of Securities Regulation issued by International Organisation of Securities Commissions ("IOSCO");
- Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision ("Basel");
- The Supervision of Cross-Border Banking by Basel and the Offshore Group of Banking Supervisors ("OGBS"); and
- Insurance Principles, Standards and Guidance Papers by the International Association of Insurance Supervisors ("IAIS").

These documents consider all aspects regarding the regulatory authority including licensing, supervisory and enforcement powers and the ability of the authority to co-operate with other regulatory and legal bodies.

In addition, the Guidance Notes introduce several concepts which are not explicitly referred to in the documents above but which are included in the scope of our review.

International co-operation and the powers of the regulator pertaining to the different financial sectors in the jurisdiction are dealt with elsewhere in this report.

This section deals solely with the consideration of the remaining principles relating to the regulator. The Supervision of Cross-Border Banking and the Insurance Principles, Standards and Guidance Papers do not refer to this subject and, as such, their content has been excluded from this discussion.

3.2 Principles relating to the regulator

The following section sets out the criteria underpinning what constitutes a regulatory authority which is deemed to meet acceptable international standards and the implications for the jurisdictions under review.

The source of the information set out in this section is Basel principle 1, IOSCO principles 1 to 5 and the Guidance Notes.

The regulatory authority should have clearly defined responsibilities, be operationally independent and accountable, have adequate powers and resources, be consistent in its approach and observe the highest professional standards including upholding appropriate standards of confidentiality.

- Clear responsibilities

Ideally the responsibilities of the regulator should be set out in law and adequate legal protection should be provided to the regulatory authority and its staff. Legislation should be designed to avoid gaps or inequities in regulation.

- Independence and accountability

The regulator should be operationally independent from external political and commercial influence and be accountable in

the use of its powers and resources. Independence is deemed to be enhanced by a stable source of funding and would be considered to be compromised by any marketing activities carried out. Approval of decisions made by the regulator by the government or a minister does not necessarily constitute a lack of demonstrable independence providing any such consultation does not include decision making on regulatory matters.

- Powers and resources

The regulator must have adequate powers and the capacity to exercise its powers, including licensing, supervision, inspection, investigation and enforcement. In many cases these powers vary across the financial sectors represented in the jurisdiction and therefore these are considered in the relevant sections of this report.

In order to exercise its tasks, the regulator must be adequately funded with the level of funding reflecting the difficulty of retaining experienced staff. Training should be provided as required on an ongoing basis.

- Clear and consistent processes

The processes adopted by the regulator should be comprehensible, transparent, fair and equitable and consistently applied. On policy decisions, the regulator is expected to consult with those who may be affected; it is generally desirable to make public disclosure of policy. The regulatory authority should also play an active role in the education of financial service industry participants.

- Staff conduct

Staff of the regulator are expected to observe the highest professional standards and be given clear guidance on conduct matters including on conflicts of interest, use of information obtained, fairness and the observance of confidentiality provisions.

3.3 **Self-regulation**

IOSCO principles 6 and 7 advocate the use of self-regulatory organisations ("SROs") in appropriate circumstances, providing the SROs are subject to the continuous oversight of the regulator and observe similar standards of conduct to the regulator itself.

3.4 **Factual assessment**

3.4.1 **Clear responsibilities**

3.4.1.1 ***Constitutional position***

By virtue of section 28(2)(a) of the Anguilla Constitution Order 1990 the responsibility for the regulation and supervision of international financial activities in Anguilla is constitutionally vested in the Governor and, through him, the British Government.

The Governor is responsible for all licensing, revocation of licences and enforcement decisions relating to regulated persons, with the exception of insurance companies under the Insurance Act, where the power is vested in the Minister of Finance (although it is the Registrar of Insurance who registers insurance companies).

3.4.1.2 ***International business***

The day-to-day regulation of international financial business is undertaken by the Financial Services Department ("FSD"). The FSD is headed by the Director of Financial Services ("the Director") who is also inspector of Trust Companies and Offshore Banks, Registrar of Insurance and Inspector of Company Management. He is supported by an assistant and secretarial staff.

The Companies Registry is also within the FSD. This is staffed by the Registrar, a Deputy Registrar and support staff. The Registrar reports to the Director.

The FSD forms part of the Ministry of Finance. For matters not vested in the Governor under the Constitution (eg budgeting and administration) the Director reports to the Minister of Finance. The Director also reports to the Minister of Finance in respect of the regulation of domestic insurance.

There is no formal statement as to the role of the regulator; rather regulatory responsibilities are contained in the various

pieces of financial service legislation in force.

As a Government department the FSD does not have its own statutory objectives although the responsibilities of the inspectors are contained in individual pieces of legislation.

3.4.1.3 ***Domestic banking***

Responsibility for the regulation of domestic banks is vested in the Eastern Caribbean Central Bank ("ECCB"), under the Banking Ordinance 1991. The ECCB regulates domestic banking in all eight member jurisdictions and is based in St Kitts. The ECCB has representative offices in each member jurisdiction, however its banking supervision functions are centralised in St Kitts.

3.4.1.4 ***Securities/investment business and mutual funds***

It is proposed that the regulation of securities/investment business and mutual funds will be the responsibility of a new organisation, the Eastern Caribbean Securities Commission, ("ECSC") which will be established under the Securities Act currently being developed by the ECCB.

The Commission of the ECSC will comprise representatives from each member territory and a representative of the ECCB. It is intended that the ECSC will also regulate the new Eastern Caribbean Securities Exchange.

Under current proposals the day-to-day supervisory responsibilities of the ECSC will be delegated to the ECCB.

3.4.1.5 ***Immunity***

Section 24 of the Company Management Act provides immunity for the Inspector and any person acting on the authority of the Governor or the Inspector for an act done in good faith in the discharge or purported discharge of his functions under the Act.

Immunity is provided by section 36 of the Trust Companies and Offshore Banking Act.

Section 228 of the Companies Ordinance provides immunity to the Registrar or any person acting under the authority of the Registrar for acts done in good faith.

3.4.2 **Independence and accountability**

3.4.2.1 ***Appointments***

The Director of Financial Services is appointed by the Governor in consultation with the Anguilla Government. As a Government department the FSD does not have a board or commission.

3.4.2.2 ***Marketing responsibilities***

The FSD is involved in marketing, primarily centred around the ACORN company registration system. Whilst it is the Registrar who has been the person primarily involved in this activity, both the Director and Registrar sit on a joint public/private sector committee which establishes the policy and programmes for marketing.

3.4.2.3 ***Annual report***

The FSD does not produce an annual report.

3.4.2.4 ***Consultation***

There is a financial services steering committee chaired by the Governor. In addition there are regular informal discussions and consultations with the private sector on regulatory and legislative development.

3.4.2.5 ***Private sector influence***

There is no evidence of any business influence over the regulatory activities of the FSD.

3.4.3 **Powers and resources**

3.4.3.1 ***Introduction***

Those parts of the Guidance Notes which relate to powers and resources pertaining to international co-operation and the powers of the regulator in respect of the different financial sectors in the jurisdiction are dealt with in the sector specific sections of this report.

The analysis of regulatory resources refers exclusively to the Anguilla FSD. No in-depth analysis of the ECCB has been undertaken as control of its regulatory responsibilities lies outside the Overseas Territories and therefore does not form part of the jurisdiction of this review.

3.4.3.2 ***Staffing***

Regulatory staffing at the FSD is very limited. Whilst senior staff (the Director and Registrar) have significant experience the limited numbers of staff make effective supervision difficult. The position is exacerbated by:

- the additional role of the Director who currently acts as Inspector of Offshore Business in Montserrat;
- the volume of new legislation recently enacted ;
- the mutual evaluation work undertaken by the Director on behalf of CFATF; and
- the marketing responsibilities of the Registrar.

However, we have been advised by the FSD that it is currently recruiting two additional staff members, one to assist with regulation and one for the registry and that training is being undertaken.

3.4.3.3 ***Budgeting***

The budgeting process is undertaken by the Director who submits a draft budget to the Permanent Secretary (Finance). The draft budget is discussed and agreed, along with all other departmental budgets, by the Executive Council (Governor in Council).

The budget of the FSD, including the Registry, for the year ended 31 December 1999 was EC$ 625,000 (approximately £160,000).

3.4.3.4 ***Sources of income***

All expenditure requirements are provided from the Government budget. All income generated from licensing and registration fees goes directly to the Government.

3.4.3.5 ***Legal support***

Legal support is provided to the FSD by the Attorney-General's Chambers. Further support, particularly in legislative drafting, is provided by an experienced English barrister when required. The level of support appears adequate and no problems have been experienced.

3.4.4 **Clear and consistent processes**

3.4.4.1 ***Involvement in legislative development***

The FSD does have a significant involvement in legislative development and either leads the development process or, at least, plays a significant consultative role.

3.4.4.2 ***Documented procedures***

The FSD does not currently have a procedures manual covering the key elements of its work namely licensing, off-site review and on-site review covering all regulated activities. We are informed that a procedures manual is being produced in respect of ACORN.

3.4.4.3 ***Disaster recovery plan***

No overall disaster recovery plan exists in the jurisdiction although ACORN is covered by a plan and a nominated secondary site.

3.5 **Issues and recommendations**

3.5.1 **Introduction**

We consider that, despite its limited resources the FSD, and particularly the Companies Registry, is well run by skilled officers.

However our review has identified a number of issues where further action is recommended. The most important of these is the lack of operational regulatory independence as licensing and other regulatory decisions are vested in the Governor rather than the regulator itself. In order to address this, and so meet the relevant international standards, the regulator must have responsibilities for licensing and supervision of regulated entities.

In addition, the current position by which the Governor is responsible for regulation but the Anguilla Government is responsible for financing the regulator is clearly undesirable as differing priorities may result in insufficient funding being made available to undertake the necessary regulatory tasks.

We detail below the issues that we consider are most urgently in need of attention.

3.5.2 **Regulatory independence**

In our view operational independence means the ability of the regulatory authority to act in the best interests of regulation (systemic, national and protection of customers) free from political and private sector interference (so avoiding the danger of regulatory capture) but with proper political accountability.

In this context we favour transferring the power of the Governor to grant and revoke licences to a new statutory body. We nevertheless consider this will only result in better compliance if it is accompanied by proper resourcing and accountability.

We consider that, in order to meet international standards, the FSD must therefore not only become an operationally independent body but that the following criteria also need to be met:

- it should have its own funding source. This would be achieved by the regulator being the initial recipient of licence fees, passing on the surplus to the government. In order to ensure efficiency, the regulator would be required to prepare budget forecasts and justify any variances by means of an annual report.
- a supervisory board should be established, to oversee the regulator and part of whose function would be the monitoring of efficiency. Membership of this board must be carefully constituted to ensure that there is no undue influence from either the public or private sector. Consideration should be given to including appropriate expertise from outside the Island to provide additional breadth in skills.

3.5.3 **Trans-national regulatory support**

Consideration should also be given as to how best to maximise regulatory resource effectiveness within the constraints inevitable in a small jurisdiction.

We have considered whether it is practical or desirable to create a regulator which, like the ECCB, is trans-national. In this instance it would cover the Overseas Territories for whom the UK Government has ultimate regulatory responsibility, namely Anguilla, Montserrat and the Turks and Caicos Islands.

We do not consider such an approach to be viable. This is partially due to the geographic distance between the jurisdictions but also because of the importance of having senior regulators present in the jurisdiction they are supervising.

Nevertheless we consider that some pooling of regulatory skills would maximise the effectiveness of the regulatory resources available, enabling effective supervision to be undertaken on a cost effective basis. For example, one jurisdiction may have a significant insurance sector, so requiring a full-time experienced supervisor, while another may only have a small insurance sector and therefore may require a similarly skilled regulator but not have sufficient need for a full-time resource.

In order to create an effective regulatory environment this issue needs to be addressed. This can be achieved in a number of ways, including:

- greater co-operation between jurisdictions in sharing regulatory resources, particularly in respect of regulatory development projects (for example developing on-site supervision programmes);
- greater sharing of resources in the carrying out of investigations or dealing with major regulatory issues; and

- the use of secondments, from both smaller to larger centres to gain experience and from larger to smaller centres to enable skill sharing.

Such an approach would need to overcome a number of key factors including cost allocation and the competition between the jurisdictions for business (although the Overseas Territories are committed to avoiding regulatory arbitrage).

A current example of this is the work of the Anguilla Director of Financial Services in assisting the regulator in Montserrat, previously referred to.

We therefore recommend that consideration is given to assessing the merits of formalising of such a resource sharing process.

3.5.4 **Marketing**

The Registrar of Companies performs a regulatory role and has been given statutory approval to assist the Director under the CMA. Therefore, for the Registrar to undertake direct marketing activities increases the risk of conflict.

Furthermore the marketing is done under the FSD banner, which does undertake regulatory functions and the Registrar reports to the Director. Therefore the potential for conflict, or at least apparent conflict, is increased further.

The Director's role in the marketing process, albeit limited, is a further drain on the limited regulatory resources.

We therefore recommend that:

- The Director should cease to have a role in the marketing of ACORN and should no longer participate in the joint public/private sector committee steering it. This is to allow him to focus exclusively on regulation.
- The FSD and the Registrar should not act as the central focus for marketing efforts, but rather marketing should be undertaken under a different name. This will remove the potential for perceived conflict.
- The Registrar should report to a person other than the Director in relation to all ACORN marketing matters. This will remove the potential for conflict in the role of the Director.

3.5.5 **Staffing**

We consider the current staffing level of the FSD to be below that needed to operate an effective regulator. This is because of the limited number of experienced staff available in the absence of the Director or Registrar. This position will be exacerbated when the current Registrar's term of contract expires at the end of 2000.

We have been advised that two further members of staff are being recruited. One of these will assist with regulation, the other with the company registry. Given the additional work being undertaken by both the Director and the Registrar this increase may not prove to be sufficient and therefore an assessment of the need for further resources should be made in December 2000.

As an independent body the regulator would be in a position to recruit new staff and remunerate existing staff on a level equivalent to that of the private sector. Irrespective of any decision regarding an independent body, efforts must be made to ensure that remuneration of regulatory staff be made comparable with the private sector in order to assist with the retention of staff.

3.5.6 **Relationship with the Eastern Caribbean Central Bank**

As a member of the Eastern Caribbean Central Bank, Anguilla may be able to utilise its resources in a number of respects. These are detailed in the following sections of this report. The effect of such assistance would be to further assist and resolve any resource constraints that may be experienced within Anguilla as it develops its offshore finance sector.

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4 Banking

4.1 Introduction

There are established international standards in place concerning the regulation and supervision of banking. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of banking conform to the standards outlined in the "Core Principles for Effective Banking Supervision" (the "Core Principles") produced by the Basel Committee on Banking Supervision ("Basel Committee"), together with the report by members of the Basel Committee and members of the Offshore Group of Banking Supervisors on the "Supervision of Cross-Border Banking".

The Core Principles comprise 25 basic principles required to be in place for a supervisory system to be effective. The Principles cover:

- preconditions for effective banking supervision (Principle 1);
- licensing and structure (Principles 2 to 5);
- prudential regulations and requirements (Principles 6 to 15);
- methods of ongoing banking supervision (Principles 16 to 20);
- information requirements (Principle 21);
- formal powers of supervisors (Principle 22); and
- cross-border banking (Principles 23 to 25).

The requirements relating to cross-border banking were developed by the report "Supervision of Cross-Border Banking". This detailed the requirements for effective home and host banking supervision in order to facilitate effective consolidated supervision including the associated necessary information flows between regulators.

Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against the above standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

4.2 Type and scale of activity

The Eastern Caribbean Central Bank ("ECCB") based in St Kitts is responsible for the supervision of commercial and local banks within Anguilla; however, it is not responsible for the "offshore" banks. There are currently four banks within the ECCB's jurisdiction in Anguilla. Total asset size for the domestic sector is approximately $EC740 million (approximately US $276 million).

"Offshore" banks (which are banks incorporated in Anguilla but whose activities are conducted with non-residents, in currencies other than the EC Dollar) are regulated under the Trust Companies and Offshore Banking Act 2000 ("TCOBA") which has just replaced the Offshore Banks and Trust Companies Ordinance 1991 ("OBTCO"). The OBTCO was introduced as part of an exercise which saw a significant reduction in banking licence holders, from forty-six in mid 1991 to one by 1993. This process was initiated following concerns as to the activities of a number of banks licensed in Anguilla.

There are currently only two organisations licensed as offshore banks in Anguilla. One of these licence holders primarily undertakes restricted merchant banking business and maintains physical presence in Anguilla. The other is a major international bank which is also regulated by ECCB for its domestic banking activities. As part of an internal restructuring the latter licence holder's offshore activities are being reduced. Two other domestic banks have applied for an offshore licence.

4.3 Factual assessment

4.3.1 **Legislation**

4.3.1.1 ***Domestic banks***

The legislation underpinning the ECCB is the Eastern Caribbean Central Bank Agreement Act 1983 and its 1993 amendment together with the Uniform Banking Act in place in the various member states. In Anguilla this is the Banking Ordinance.

The ECCB Agreement Act empowers the ECCB to take action to protect depositors and creditors of financial institutions, including the assumption of control, the acquisition and sale of assets, and the restructuring of financial institutions.

Under the Banking Ordinance the Anguilla Minister of Finance is empowered to grant and withdraw licences on the ECCB's recommendation.

4.3.1.2 ***Offshore banks***

As stated above offshore banking is now governed by the TCOBA which replaces the "OBTCO" as amended by the Offshore Banks and Trust Companies (Amendment) Ordinance 1998.

The TCOBA covers a range of issues including:

- application procedure;
- powers and duties of the Inspector;
- powers of the Governor;
- returns requirements;
- powers of search; and
- minimum capital requirements.

The TCOBA permits the Inspector broad gateways of communication with other regulatory authorities in relation to the affairs of licence holders.

Prior to making a disclosure the Inspector must be satisfied that the other regulatory authority is subject to adequate legal restrictions over onward disclosure and that disclosure is required for their regulatory function.

The gateway is available to passing information to banking, insurance and company management regulators.

4.3.2 **Regulations**

4.3.2.1 ***Domestic banks***

Section 33 of the Banking Ordinance gives the Anguillan Minister of Finance the power to introduce regulations and orders as may be required from time to time for giving effect to the provisions of the Ordinance, upon the recommendation of the ECCB.

The regulations have the force of law and have been used sparingly. They comprise:

- Banks & Trust Companies (Amendment of Fees) Order, 1996 made 31 Dec 1996;
- Banks & Trust Companies Regulation 1992 made 6 June 1991;
- Banks & Trust Companies (No 2) Regulations made 17 September 1991;
- Banks & Trust Companies (Application Procedures) Directions made 14 June 1991;
- Banks & Trust Companies (Deposit/Investments) Directions made 1 May 1992; and
- Banks & Trust Companies (Non-negotiable Certificates) Order made 30 March 1992.

The Ordinance also empowers the Anguillan Minister of Finance, acting in consultation with and on the recommendation of

the ECCB to issue orders to amend existing provisions of the Ordinance. For example, orders could be issued to change the requirements for licensing or capital adequacy provisions. The Orders provide flexibility as changes can be made without the requirement to alter primary legislation itself.

Orders have been issued to extend the provisions of the Ordinance to finance companies and to prescribe the format and minimum information content of published financial statements.

4.3.2.2 ***Offshore banks***

Two regulations were issued under the OBTCO:

The Offshore Banks and Trust Companies Regulations 1992 provided details of the application process and certain basic requirements such as the obligation to provide half-yearly statements of assets and liabilities.

The Offshore Banks and Trust Companies (Application Procedures) Directions 1992 detailed the procedures to be followed for a banking licence application.

4.3.3 **Guidance notes**

4.3.3.1 ***Domestic banks***

The ECCB issues prudential guidelines to domestic banks. These guidelines are designed to promote sound and prudent behaviour in the banking sector. The ECCB places strong reliance on compliance with the guidelines and will take action against those licence holders who fail to comply.

The ECCB has issued prudential guidelines to the banking sector to introduce a number of measures including the implementation of the recommendations of the Basel Committee where these were not already covered by existing laws and regulations.

Guidelines have also been issued regarding aspects of financial institutions' operations relating to risk based capital adequacy requirements, large credit exposures, annual loan classification, loan loss provisioning, suspension of interest and write-off procedures.

The ECCB considers the use of guidelines to be effective but can issue them as regulations if necessary.

4.3.3.2 ***Offshore banks***

Guidance was issued in 1994, setting out the criteria to be met before an offshore bank will be licensed. This is detailed in section 4.3.4.2 below. Guidance in respect of auditors reports to the regulator has also been issued.

4.3.4 **Supervision - systems and procedures**

4.3.4.1 ***Domestic banks***

All banks licensed by the ECCB are required to maintain a minimum capital level of EC $5 million (approximately US $1.9 million) together with a reserve requirement of 5% of deposits/specified liabilities.

Off-site supervision

On a weekly basis a review of the reserve position is undertaken and on a monthly basis certain forms including a balance sheet are required to be submitted electronically. In the case of a branch, the balance sheet of the branch, of the operations within the ECCB region as a whole and of the company of which the branch forms a part, are all required to be submitted. On a quarterly basis forms covering such matters as delinquency, large credit and deposit exposures, profit and loss and provisioning are submitted.

In undertaking its risk assessment the ECCB uses the Basel capital adequacy model as amended by the Caribbean Group of Banking Supervisors. In general its risk assessment is based upon the American standard within which the main risks assessed are credit and investment risks.

On a yearly basis the annual audited financial statements are submitted and reviewed.

On-site inspection

The ECCB conducts on-site reviews on a regular basis of all banks for which it has responsibility. Prior to each visit a pre-questionnaire is submitted by the ECCB to the relevant bank. This document is structured in a similar manner to the UK's CAMEL regime such that banks are evaluated with respect to Capital adequacy, Asset quality, Management, Earnings and Liquidity.

Following an on-site inspection by the ECCB, banks are either assessed as having no issues requiring further action or are requested to provide a letter of commitment under which the bank agrees to undertake certain corrections, or potentially an MOU is issued requiring that the bank corrects certain matters within a specified time.

On-site supervision is generally undertaken by at least 5 persons and takes 2-3 weeks. In undertaking on-site supervision regulatory staff are guided by the Manual of Operations, which is based on the US Federal Reserve Manual. The ECCB manual is currently being updated.

In addition to the above, the ECCB also conducts prudential meetings with the management of the banks. These meetings cover the performance of the subject institution, management strategy, and other pertinent areas.

The ECCB also has quarterly meetings collectively with all the domestic banks in Anguilla.

4.3.4.2 ***Offshore banks***

Regulatory structure

Under the TCOBA the Governor of Anguilla has overall responsibility for granting and revocation of licences. The TCOBA also provides for the appointment of an Inspector of Trust Companies and Offshore Banks, known as the Inspector of Banks. The Inspector reports directly to the Governor.

Day-to-day supervision has been vested, under the TCOBA to the Inspector. The Inspector is Director of the Financial Services Department ("FSD"), which acts as Anguilla's regulatory body and is a department in the Ministry of Finance.

Licensing

The vetting procedures for licensing are contained in the Offshore Banks and Trust Companies Regulations.

The Governor will only grant a licence if he is of the opinion that it is not against the public interest to do so and that the applicant is suitably qualified. There is a positive fit and proper test contained within the TCOBA.

Furthermore, banks will only be considered for licensing if the following criteria are met:

- it is a branch or subsidiary of a bank with a well-established and proven track record and which is subject to effective consolidated supervision by their home supervisory authority; or
- it is a bank, which, although not a subsidiary, is closely associated with an overseas bank, and which, by agreement, will be included within the consolidated supervision exercised by the overseas bank's home supervisory authority; or
- it is a wholly owned subsidiary of an acceptable non-bank corporation whose shares are quoted on a recognised stock exchange where the objective of the subsidiary is to undertake in-house treasury operations only, and where the operations are fully consolidated within the published financial statements of the parent company.

Banks must also demonstrate "mind and management" in the jurisdiction of incorporation unless they are a subsidiary and the "mind and management" is located in the jurisdiction where consolidated supervision is undertaken.

The TCOBA contains a capital requirements of at least US$ 250,000.

Details of the application process are contained in the "Offshore Banks and Trust Companies (Application Procedure) Directions 1992". This includes the information which needs to be supplied with the application, including details from each shareholder or director as well as the proposed officers or managers of the bank. A business plan is also required.

The provision of false information is a criminal offence.

Licence holders are required to appoint two authorised agents resident in Anguilla.

Supervision

Off-site inspection is undertaken through the receipt and analysis of half yearly returns from licence holders.

The Inspector undertakes a number of meetings each year with each licence holder. There is no formal on-site inspection process.

4.3.5 **Enforcement - systems and procedures**

4.3.5.1 ***Domestic banks***

The ECCB has introduced a hierarchy of remedial actions. These may take the form of the following:

- commitment letters;
- memoranda of understanding;
- formal agreements (including cease and desist orders);
- capital directives; and
- removal of a licence or suspension.

4.3.5.2 ***Offshore banks***

Where a licence holder has contravened a provision of the TCOBA, failed to comply with a condition of its licence, is carrying on its business in a manner detrimental to the public interest or is unable to meet its obligations, the Governor has a wide range of enforcement powers.

These include:

- revocation of licence;
- imposition of new or additional conditions;
- substitution of a director or officer;
- appointment of a person to advise the licence holder;
- appointment of a person to assume control of the licence holder's affairs; and
- requiring the licence holder to take such action as the Governor thinks fit.

The Inspector has the power (under section 187 of TCOBA) to petition the courts to wind up a licence holder.

4.3.6 **Depositor protection schemes**

No depositor protection scheme is currently operating or intended.

4.3.7 **Anti-money laundering**

Licence holders are subject to anti-money laundering legislation and will be subject to a regulatory code once introduced, which will cover, *inter alia*, "know your customer" requirements.

Breach of the anti-money laundering legislation regulations represents a disciplinary offence by the licence holder.

4.4 **Issues and recommendations**

4.4.1 **Introduction**

Domestic banks

The remit of our review does not include a detailed analysis of the ECCB as this body does not come within the jurisdiction of Anguilla. Our review has therefore comprised consideration of the relevant legislation and discussions with the ECCB.

We have not independently verified the accuracy of the information provided to us.

The ECCB has advised us that amendments are required to its current banking ordinances to ensure that it is in full compliance with the 25 core principles outlined by the Basel Committee. In particular the ECCB needs to ensure it has cease and desist powers and is also able to exchange information. Currently the ECCB has no authority to share information with other regulators.

The ECCB does not consider this inability to share information as a particular problem as no locally incorporated banks have business outside the region. Branches of international banks are, however, licensed by the ECCB.

The proposed areas for consideration in the revision to the Banking Ordinance are:

- supervision on a consolidated basis (expanding the authority of the ECCB);
- introducing cease and desist orders where institutions fail to meet prudential standards;
- improving information exchange with other regulators;
- expanding authority regarding controlling the ownership of shares in a licensed bank;
- improving capital adequacy requirements;
- restrictions on certain activities (particularly regarding large credit exposures); and
- procedures for the removal and resignation of auditors.

The ECCB is hopeful that a change in the law will be in place by the end of December 2000. It has developed a model amendment but this is at a departmental level within ECCB and was not available for general comment at the time of our review.

It is important that the necessary amendments to bring the banking legislation in line with the Basel Committee principles are made and the necessary changes to Anguilla legislation introduced as soon as agreement with the ECCB is reached.

Offshore banks

The fact that there is currently, effectively only one licensed offshore bank in Anguilla means that the introduction of a substantial regulatory structure is neither required nor practical. Obviously, as further licences are granted a more formalised and documented regulatory structure would be required (supplemented by the Bank Licensing Guidelines referred to above) and the FSD agrees with this.

The issues and recommendations detailed below are designed to assist Anguilla in optimising practical supervision.

We also raise the possibility of transferring the regulatory supervision of offshore banks to the ECCB. Whilst this is not required to enable sound banking supervision of the sector we do consider it to be a possible approach and one to be considered if the offshore banking sector in Anguilla were to develop.

4.4.2 **Supervision of offshore banks**

The Inspector of Banks relies heavily on regular, informal discussions with the licence holder. Given the sector's size this is not unreasonable. We do consider certain formalising of the position would, nevertheless, be of benefit and therefore recommend that:

- formal documented, prudential meetings should be held (both with the licence holder and its auditor) as well as the current, more informal, regular meetings;
- the Inspector should also be given authority to conduct on-site visits and undertake reviews of client files to ensure that any regulations, including those relating to anti-money laundering, are being complied with.

We note that the Inspector is putting in place enhancements to the provision of half-year financial statements by increasing this to a quarterly requirement and adding a maturity analysis report. We have also been advised that the legislation will be amended to include the power to undertake on-site inspections. FSD have represented to us that this power is now in place

under the new legislation.

We consider these to be further positive moves and recommend that these enhancements are in place by 31 December 2000.

4.4.2.1 ***Role of the auditor***

We consider that the duty of reporting imposed on an auditor should be combined with an indemnity from the general duty of confidentiality in such reporting.

4.4.3 **A single banking regulator**

As a general principle we do not consider the division of regulatory responsibility according to the type of bank to be the most efficient and effective use of regulatory resources. We believe that a single banking regulator would be more appropriate as it allows more efficient and effective use of resources to be developed for supervision based on risk assessment.

Given the significant difference in resource capability between the ECCB and the local regulator and the ECCB's stated desire to extend its scope to cover offshore banks, it is our view that consideration should be given to the ECCB assuming this role under some form of arrangement. This may require resolution of any constitutional issues relating to the authority of the Governor in Anguilla. In particular it would be important to ensure that questions of sovereignty in licensing and similar decisions are properly addressed. This may necessitate the delegation, rather than surrender, of regulatory authority to the ECCB. Consideration may also be given to delegating the day-to-day supervision of offshore banks to the ECCB whilst the power to license and revoke is retained by the Governor or other independent licensing body.

Whatever the ultimate arrangement it is important that the ECCB, in extending its regulatory scope to include the offshore banks, ensures that it takes appropriate cognisance of the difference in role, client base and risks associated with these types of banks and develops its regulatory requirements accordingly. It must also ensure it verifies compliance with anti-money laundering regulations and guidance notes as part of its on-site inspection.

If regulation is delegated to the ECCB it should be subject to some form of review by the regulator in Anguilla over how it discharges its delegated functions.

We welcome your comments on this site.

Prepared 27 October 2000

5 Insurance

5.1 Introduction

The International Association of Insurance Supervisors ("IAIS") has produced a number of principles and standards set out in a series of papers and approved by its members.

These standards recognise that the regulatory framework for insurance supervision varies from country to country and are not mandatory and do not necessarily reflect current practice in all of the member countries. The principles and standards are intended to represent a target for supervisors to work towards and can be implemented in a flexible manner depending upon the circumstances of each jurisdiction.

The Offshore Group of Insurance Supervisors ("OGIS") has also introduced a set of principles, standards and guidance notes upon which self-assessment is required. Conditions of membership of this group include, having legislation in place which enables its regulatory authority to adequately supervise insurance business by having the necessary resources and properly qualified supervisory personnel to enforce the legislation.

Of the territories under review, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of OGIS, with Anguilla having observer status. Anguilla is a member of IAIS.

The Terms of Reference for this review require us to assess performance against International Standards and Good Practice in the insurance sector.

It is against these standards that we have made our assessments. The areas where it is considered that development may be required are contained in the issues and recommendations section of this report.

5.2 Type and scale of activity

The scale of insurance activity in Anguilla is extremely limited. We have considered the sector carefully and our comments below reflect this position.

Anguilla's insurance industry is dominated by the domestic sector. Other than the number of companies operating there are no insurance statistics available. The total number of companies licensed are:

Domestic market 17 (including 2 locally incorporated companies which transact mainly motor insurance)

Offshore 1 (captive insurance company)

With the exception of two local companies, all others are external insurers, whose head office is located in another jurisdiction. In Anguilla they are represented by local agents. One external insurer maintains a branch office. The majority have less than US$ 100,000 premium income. It is estimated by the private sector that the total premium income is less than US$ 5 million There are five or six major insurance companies in the domestic market.

Agents are not licensed under existing legislation but are appointed by the external insurer and notified to the Superintendent of Insurance.

5.3 Factual assessment

5.3.1 Legislation

The main legislation applicable to insurance is:

- The Insurance Act 1968, which covers the registration and regulation of insurance companies;
- The Insurance Regulations 1970, which cover reporting forms and procedures;
- The Insurance Act (Amendment) Ordinance 1985 which provides a fee schedule; and

- Insurance Amendment Act 1998, which provides for gateway provisions.

The existing laws provide a basic framework for domestic insurance in Anguilla and a minimum level of regulatory supervision. The Insurance Act provides basic regulations in respect of the registration of insurance companies, reporting requirements and limited powers of intervention. The FSD accepts that the sanctions and penalties are out of date and that new legislation should be introduced as soon as possible.

In 1998 it was proposed that Anguilla introduce the ECCB Model Insurance Act; this has not occurred as the Act only covered domestic insurance and currently new legislation, based on the British Virgin Islands Insurance Act, is awaiting enactment.

It should be noted that all applications received in the last 2 years have been from external insurers wishing to operate in the domestic market which are regulated by other domiciles.

5.3.2 **Rules, regulations and guidance notes**

The 1970 Insurance Regulations included reporting forms which, the regulator accepts, do not provide sufficient financial information. Consequently, the FSD has recently issued new reporting forms in an endeavour to obtain relevant statistics. The FSD have represented to us that since the date of our visit revised forms have been sent out to all insurers for completion to reflect their 1999 insurance activity.

No specific rules and regulations other than the 1970 Regulations (as updated in 1999) exist and it is not proposed that any will be issued prior to the introduction of the new legislation referred to above.

There have been no guidance notes nor guidelines issued by the authority for insurance and it is not expected that any guidelines will be issued until the new legislation is introduced. Though FSD has confirmed that regulations will be issued together with the legislation.

5.3.3 **Supervision - systems and procedures**

The Minister of Finance is responsible for registering insurance companies, his decision is based on the recommendation of the Director of Financial Services.

We are advised by the FSD that with the exception of the two locally-incorporated companies which carry out mainly motor insurance business, there is no ongoing regulation of the insurance sector other than an annual request for the submission of accounts and reporting forms set out in the Insurance Regulations. However, 15 of the 17 companies carrying on domestic business are regulated by an overseas home regulator. In respect of these, no review or evaluation had been undertaken at the time of our visits.

The Director of Financial Services acts as the Superintendent of Insurance. There are no staff with insurance industry experience.

There are no rules or requirements for the calculation of admitted or non-admitted assets or asset valuations to support liabilities. Similarly there is no requirement or guidance for assets to remain in Anguilla to match liabilities. The regulator may request that, under the legislation, a deposit of 10% of premiums should be made if it is deemed to be necessary. This deposit has been obtained in the case of 4 companies.

Although provisions are in place for the regulator to check technical reserves and loss reserves for claims liabilities, this does not take place as no staff are available and no standards have been set. Equally there are no provisions to require technical reserves for life insurance companies to be set by an actuary, although an actuarial report is required every 5 years.

It is accepted that on-site inspections are not possible due to the lack of staff.

As there is no legislative requirement to licence agents, no supervision takes place although agents are notified to the Superintendent.

5.3.4 **Enforcement - systems and procedures**

There exists no real authority, systems or procedures to enforce the Insurance Act. However, the regulator does have the power to investigate, if he feels it necessary in the interests of policyholders, and petition for the winding-up of the company.

5.3.5 **Policyholder protection schemes**

There are no policyholder protection schemes in force.

5.4 Issues and recommendations

5.4.1 Introduction

Following discussion with the Director of Financial Services, we agree that existing legislation was designed for domestic insurance only. We also agree with the Director that the offshore insurance sector should not be developed until the new legislation and accompanying regulations are introduced.

Therefore, until a new insurance law meeting international standards is introduced, approved and properly implemented, it is recommended that the regulatory authority does not accept any applications from companies wishing to establish offshore insurance companies in Anguilla.

5.4.2 Legislation

The legislation operating in Anguilla (Insurance Law 1968) is out of date and does not accommodate modern regulatory controls and standards, particularly in the area of sanctions and penalties. However, updated legislation is proposed.

Recent licence applications have been exclusively received from external insurers wishing to operate in the domestic market and which are regulated by other jurisdictions. Whilst this may provide some comfort it does not remove the need for proper regulation in Anguilla.

The proposed draft insurance legislation (the Insurance Act 2000) has been reviewed and includes regulations for both domestic and offshore insurance business. It is adequate for a jurisdiction of this size which does not necessarily require two separate insurance acts. It is unlikely that the domestic market will grow excessively and the provisions in the proposed Act in relation to this class of business appear adequate if properly implemented.

5.4.3 Licensing and off-site supervision

Whilst there are no statistics available on the size of the domestic market, gross premium income is estimated to be in the region of US$ 4 million. The major risk being hurricane damage in the domestic market. It would appear that the operating companies have reinsurance in force. It is not possible however to verify the adequacy of cover from the files which contain little or no information other than financial reports.

We therefore recommend that a facility for recording industry information and statistics is introduced, and that reinsurance programmes for domestic carriers are reviewed and approved annually. The FSD has represented to us that revised forms to address this point are in place.

A detailed process for checking and vetting shareholders, directors and controllers should also be introduced and procedures prepared that will assist the application process for the licensing of captive insurance companies. We are advised that, subsequent to our visits, this procedure is now in place.

5.4.4 Resources

Although Anguilla does not have a developed offshore captive insurance market (there is only one licensed captive insurance company writing re-insurance cover for its parent company, which is licensed in Vermont USA and which complies with the reporting procedures as far as they exist) resources available to effectively supervise the industry are insufficient.

Furthermore, current resources are unable to satisfactorily evaluate statutory returns, and review insurance and reinsurance procedures. In addition to the generic

recommendations made in the section covering the regulatory authority, we would advocate that a properly resourced, trained and experienced insurance supervisor is required to carry out the detailed analysis of financial reporting returns as part of a new off-site supervision programme.

5.4.5 On-site inspection

To date it has not been possible for the regulator to carry out on-site inspections due to lack of experienced supervisory staff. We recommend that because of the resource limitations, priority should be given to the establishment of procedures to obtain information relating to the underwriting policy, reinsurance programme, claims management and reserving policies and

record keeping, as a first step towards more effective on-site supervision.

We welcome your comments on this site.

Prepared 27 October 2000

6 Securities / investments

6.1 Introduction

There are laid down international standards in place concerning the regulation and supervision of those involved in the securities and investments sector. The Terms of Reference for this review requires us to look at whether the arrangement for the regulation of securities and investments conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

The relevant IOSCO Principles for this section include:

- the responsibilities of the regulator should be clear and objectively stated (Principle 1);
- the regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. (Principle 3);
- the regulator should adopt clear and consistent regulatory processes (Principle 4);
- the regulator should have comprehensive inspection, investigation and surveillance powers (Principle 8);
- the regulator should have comprehensive enforcement powers (Principle 9);
- the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme (Principle 10);

It is against the IOSCO standards that we have primarily made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

For the purpose of this report we have defined Securities/Investment business as covering the following range of activities:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

Legislation and regulation relating to the mutual funds is covered in the following section.

6.2 Type and scale of activity

No formal statistics or other information is available on the scale of securities/investment business in Anguilla, although we are advised by the Anguilla Financial Services Department ("FSD") that this business is being undertaken on a very limited scale in Anguilla. Only two firms are believed to be involved in these activities, one of which is a major US brokerage house and is operating through one of the domestic banks.

6.3 Factual assessment

6.3.1 Legislation

Whilst there is currently no legislation covering the regulation of securities or investment business, the Eastern Caribbean Central Bank ("ECCB") are currently developing a draft Securities Act (the "draft Act") to accompany the development of the Eastern Caribbean Stock Exchange. It is proposed that this legislation, when finalised, will be introduced by all the ECCB member countries, including Anguilla.

ECCB propose that there will be a Securities Commission ("ECSC") and this will have powers to supervise those engaged in

securities business. We have been advised by the Director of the Anguillan FSD that it is not yet clear who will have power to authorise investment businesses in Anguilla.

We have been advised by the ECCB that the draft Act is not formally based on one piece of legislation but several including Trinidad, Barbados and Jamaica.

6.3.1.1 *Other legislation*

There is no legislation in place in Anguilla which makes market manipulation and insider trading a criminal offence.

6.3.2 Regulations and guidance notes

As there is no current legislation, there are no regulations or guidance notes in place covering investment and securities business.

Under the draft Act, the Anguillan Minister of Finance may, on the recommendation of the ECSC, make regulations prescribing the manner in which licence holders are required to conduct their business.

6.3.3 Supervision and enforcement - systems and procedures

As there is no current legislation, no systems or procedures relating to supervision and enforcement are in place covering investment and securities business.

ECCB proposes that the ECSC will have the power to impose conditions on a licence and, in certain circumstances, revoke or suspend a licence. It will also be able to issue directions to licence holders, the breach of which will be a criminal offence.

We understand from the ECCB that whilst ECSC will be responsible under the legislation, day-to-day supervision will be undertaken by the ECCB.

Furthermore, under the draft Act the ECSC will have power in certain circumstances, to appoint an auditor to examine, audit or report on the books, accounts and records of the licence holder and on money, securities or other property held on account of any other person by the licence holder (or his nominee).

There are no proposals within the current draft Act for other disciplinary action such as:

- public reprimands (naming and shaming);
- fining; or
- the declaring of an individual not to be fit and proper.

No final details as to the enforcement systems and procedures have been produced.

6.3.4 Investor compensation schemes

No investor protection or compensation schemes are proposed under the draft Act.

6.4 Issues and recommendations

6.4.1 Introduction

The scale of investment and securities activity currently undertaken in Anguilla appears to be small, however, activity may well increase as Anguilla develops its offshore activities. There is therefore a need to introduce securities and investment business legislation to ensure Anguilla's compliance with IOSCO principles in this area.

We consider that the most effective way of achieving this is through the introduction of the legislation proposed by the ECCB. Once the draft Act is finalised Anguilla should make its introduction a priority.

6.4.2 Conflict between draft Securities Act and constitutional position in Anguilla

The draft Act will encompass both onshore and offshore activity. Accordingly there is a constitutional issue arising since the Governor of Anguilla is responsible under the Anguillan constitution for the international finance sector and its regulation, however, the draft Act gives the power to the ECSC.

The constitutional position should therefore be considered and resolved as a matter of priority.

6.4.3 **Draft Securities Act**

An assessment should be made, in advance of the introduction of this legislation, to ensure that the draft Act and regulations made under it are consistent with IOSCO Principles.

In our view for the draft Act to meet IOSCO standards, ECCB would need to demonstrate that it has sufficiently trained and experienced resources to fulfil the day-to-day regulatory role and the ECSC should have the necessary resources to confirm that the delegated responsibilities are being conducted properly. This will include ensuring the independence of the Regulator.

6.4.4 **Supervision**

We consider that any on-site supervisory regime developed for managers should pay particular attention to the methodology for supervising licence holders, if any, who have no real presence in Anguilla.

We welcome your comments on this site.

Prepared 27 October 2000

7 Mutual Funds

7.1 Introduction

There are established international standards in place concerning the regulation and supervision of collective investment schemes/mutual funds (referred to hereafter as mutual funds). The Terms of Reference for this review require us to look at whether the arrangements for monitoring, supervision and the regulation of mutual funds conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

Among the IOSCO Principles there are specific principles relating to collective investment schemes; these are:

- that the regulatory system should set standards for the licensing and the regulation of those who wish to market or operate a collective investment scheme (Principle 17);
- the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client money and assets (Principle 18);
- regulation should require full, timely and accurate disclosure of financial results and other information which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme (Principle 19);
- regulations should ensure that there is a proper and disclosed basis for asset valuation and the pricing and redemption of units in a collective investment scheme (Principle 20).

Other Principles, particularly regarding the regulator, enforcement and co-operation also apply to the regulation and supervision of schemes.

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

7.2 Type and scale of activity

Whilst there is a theoretical possibility that a unit trust structure could be developed (as there are no requirements for trusts to be registered), there is no evidence of any mutual funds operating on or from the island and this section should be read in that context.

7.3 Factual assessment

7.3.1 Legislation

Whilst Anguilla has no legislation relating to mutual funds currently in place, a legislative and regulatory regime for mutual funds is proposed under a draft Securities Act (the "draft Act") prepared by the ECCB. This draft Act will apply to Anguilla once it is introduced and the necessary legislation is passed to bring it into effect in the jurisdiction.

Under the draft Act, the Eastern Caribbean Securities Commission ("ECSC") will be responsible for the approval of the funds. The ECSC is required to inform an applicant of the result of the application within three months of it being submitted.

Whilst regulation will be the formal responsibility of the ECSC, the actual obligation may be delegated by it to the ECCB.

7.3.2 Regulations and guidance notes

As there is no current legislation, no regulations or guidance notes are in place covering mutual funds.

The regulation of mutual funds will be governed by section 72 of the draft Act which provides that the Anguillan Minister of Finance may, on the recommendation of the ECSC, make regulations with regard to areas such as the:

- authorisation of collective investment schemes;
- constitution and management of collective investment schemes, the powers and duties of the manager and custodian of the scheme;
- promotion, marketing and distribution of units;
- the issue and redemption of units;
- provision of management or custodial services; and
- preparation and submission of reports to the ECSC.

A breach of a regulation is actionable by any person who suffers loss as a result of the contravention.

By virtue of section 113 of the draft Act, the ECSC will have the power to issue guidance notes.

7.3.3 **Supervision and enforcement - systems and procedures**

As there is no current legislation, no systems or procedures relating to supervision and enforcement are in place covering mutual funds.

The supervisory and enforcement regime under the draft Act has not yet been finalised but we understand day-to-day supervision may be delegated from the ECSC to the ECCB.

7.3.4 **Investor compensation schemes**

There is no scheme in place nor is one proposed under the draft Act.

7.4 **Issues and recommendations**

7.4.1 **Introduction**

We are informed that Anguilla has no mutual funds in operation. However it may be possible for funds from other jurisdictions to be marketed directly to residents in Anguilla. Therefore, the current lack of a legislative and regulatory framework for funds should be remedied.

Furthermore, Anguilla may wish to develop this part of its offshore financial services activity in the future.

We consider that a possible method for developing a legislative and regulatory structure would be through the draft Securities Act developed by the ECCB. There are a number of issues relating to this and these are dealt with below.

7.4.2 **Conflict between laws and constitutional position**

There appears to be a conflict between the constitutional responsibility of the Anguilla Governor for the offshore finance sector of the jurisdiction and the mutual funds proposed to be encompassed by the draft Securities Act which may well include "offshore" funds (i.e. funds that are designed to be sold outside Anguilla).

Anguilla therefore has four choices in relation to the development of legislation in this area:

- if possible, the constitutional position of the Governor could be amended with respect to this part of the offshore finance sector and follow the route proposed in the draft Securities Act;
- it may retain the current constitutional position but delegate the day-to-day supervision to the ECSC, retaining the Governor's role for the granting and revocation of licences;
- it may seek to restrict the funds covered by the draft Securities Act to those which will be listed on the new Eastern Caribbean Securities Exchange (discussed in the next section to this Report). Anguilla should then develop its own legislation for other mutual funds; or

Anguilla may wish to consider the route of introducing its own mutual funds law for all funds if the undertaking of the functions by the ECSC would put the jurisdiction at a competitive disadvantage.

In our view, the limited resources currently available within the Anguillan regulatory system preclude options three and four at present. We therefore recommend consideration is given to pursuing either the first or second options although with additional resources Anguilla may wish to pursue options 3 and 4.

7.4.3 **Draft Securities Act**

As stated in 6.4.3 above an assessment should be made, in advance of any legislation being introduced, to ensure that the draft Securities Act and regulations made under it are in line with IOSCO Principles.

As in the case of the regulation of securities/investment business, in our view for the draft Act to meet IOSCO standards ECCB should demonstrate that it has sufficiently trained and experienced resources to fulfil the day-to-day regulatory role and the ECSC should have the necessary resources to confirm that the delegated responsibilities are being conducted effectively.

We welcome your comments on this site.

Prepared 27 October 2000

8 Stock Exchange

8.1 Introduction

There are established international standards in place concerning the regulation and supervision of stock exchanges. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of these exchanges conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

The IOSCO principles which relate to the oversight and regulation of stock exchanges are as follows:

- Self-regulation (principles 6 and 7);
- Issuers (principles 14 to 16);
- Market Intermediaries (principles 21 to 24); and
- The Secondary Market (principles 25 to 30).

The principles for self-regulation address two supervisory relationships. The first of these covers the supervisory activities of the exchange as a self-regulatory organisation ("SRO") and is addressed in this section of the report. The second principle relates to the oversight by the regulator of its SRO and is covered in the section on the regulatory authority.

8.2 Type and scale of activity

There is currently no Stock Exchange in Anguilla and consequently no activity. However an Eastern Caribbean Securities Exchange ("ECSE" or "the Exchange") is in the process of development and this Exchange will include Anguilla together with the other seven members of the ECCB.

According to the "Market Structure Blueprint for the Development of the Eastern Caribbean Securities Exchange" prepared in January 2000 by the Financial and Enterprise Development Unit in the Governor's Office of the ECCB, the objective of the ECSE is to develop Eastern Caribbean economies through the creation of alternative sources of capital.

8.3 Factual assessment

8.3.1 Legislation

A draft Securities Act has been developed and circulated. Under this law the ECSE which would be created would be an SRO. The ECSE will establish rules and guidelines which will determine the parameters of operations for all activity taking place within its boundaries. Supervision of the Exchange will be conducted by a new regulator, the ECSC. It is proposed that the Exchange will be owned and controlled by the private sector.

8.3.2 Rules, regulations and guidance notes

Given that there is no existing stock exchange there are currently no regulations or guidance notes.

8.4 Issues and recommendations

The lack of finalised legislation and published regulations by ECCB/ECSI precludes a full and effective evaluation of the proposals against international standards and good practice.

As the ECSE is to be private sector owned and controlled and will operate as both a business and an SRO we consider that strong safeguards should be introduced by the ECSC to ensure effective regulatory oversight.

Furthermore whilst it is proposed that regulation will be formally carried out by the ECSC, the actual obligation is likely to be assigned by the Securities Commission to the ECCB.

In our view for this arrangement to meet international standards, the ECCB would need to demonstrate that it has sufficiently trained and experienced resources to fulfil its role. The ECSC should also have the necessary resources to confirm that the ECCB is fulfilling its assigned obligations properly.

We welcome your comments on this site.

Prepared 27 October 2000

9 Companies

9.1 Introduction

As recognised by the TOR, there are no specific international standards concerning the regulation and supervision of companies. However, there are a number of international standards concerning the operation and management of companies. These include the OECD "Principles of Corporate Governance", the G7 "Report on Transparency and Accountability" and the IMF "Guide to Progress in Strengthening the Global Financial Architecture". There is also the work of the International Accounting Standards Committee. Whilst other international standards exist, these primarily relate to particular financial services activities such as banking, securities and insurance and many of their requirements are not directly applicable to ordinary trading and holding companies.

The OECD Principles cover:

- the rights of shareholders;
- the equitable treatment of shareholders;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board of directors.

The Guidance Notes cover the following additional issues with regard to companies:

- the ability of law enforcement and regulatory authorities to identify quickly and efficiently the shareholders and directors of a company and the beneficial owners of a company's shares;
- the ready availability of financial information relevant to the activities of companies to law enforcement and regulatory authorities;
- requirements concerning accounting disclosure and auditing practice, particularly where there are obligations to third parties;
- the circumstances in which accounts should be produced and when accounts should be made public;
- the investigative and enforcement powers available to the OT; and
- standards of corporate governance.

The TOR and the Guidance Notes cover companies and company service providers together. However, we consider that it is useful to consider them separately, which we have done in this Report.

We consider that the regulation of company service providers is the most practical and effective way of deterring the abuse of company structures and of ensuring that relevant information is available to law enforcement and regulatory authorities. This approach is in accordance with the views expressed in the recent UK Home Office "Review of Financial Regulation in the Crown Dependencies". Nevertheless, there are areas where the requirements imposed upon companies themselves should be enhanced.

In considering these enhancements, we have not undertaken a review of company or insolvency law as a whole. The TOR do not require us to do this. Instead we have assessed the legislation and regulation of companies in Anguilla against the international standards referred to above and the criteria in the Guidance Notes as summarised above.

9.2 Type and scale of activity

Three types of company may be incorporated in Anguilla, a company ("CO company"), incorporated under the ("CO") an

international business company ("IBC") incorporated under the IBC and a limited liability company ("LLC") formed under the Limited Liability Company Ordinance ("LLC Ordinance").

The table below shows the number of companies incorporated in the year ended 31 December 1999 and the total number of companies on the register as at that date.

Type of company	1999	Total to 31 December 1999
CO Companies	203	1,323
IBCs	495	1,742
LLCs	20	78

Anguilla has also recently introduced an on-line incorporation facility known as ACORN. This is an acronym for "Anguilla's Commercial On-line Registration Network".

No statistical information is available concerning the uses to which CO companies, IBCs or LLCs are put or concerning the main markets for the companies.

9.3 **Factual assessment**

9.3.1 **Legislation**

9.3.1.1 ***Introduction***

As stated, there are three pieces of corporate legislation in Anguilla, the CO, the IBC Ordinance and the LLC Ordinance. All the legislation is administered by the Registrar of Companies ("the Registrar").

There is also a Companies Registry Ordinance.

9.3.1.2 ***Companies Registry Ordinance 1998 ("CRO")***

This Ordinance was introduced to provide for the keeping of registers by the Registrar of Companies and the filing of documents in electronic form. The Ordinance, therefore, provides the statutory underpinning of the ACORN company registration system.

Under the Ordinance only persons authorised by the Registrar of Companies, may submit documents in electronic form. The authorisation process is covered in the section on Company Service Providers ("CSPs").

Section 13 of the CRO provides that every document filed with the Registrar is available for public inspection unless the Registrar is required to keep the document confidential by the CRO or by any other Ordinance.

9.3.1.3 ***Companies Ordinance 1994 (as amended by the Companies (Amendment) Ordinance 1998 ("CO"))***

The CO provides for the incorporation, administration and operation of companies in Anguilla and ancillary matters such as financial disclosure, insolvency and winding up.

A CO company may be:

- a company limited by shares;
- a company limited by guarantee; or
- a company limited by both shares and guarantee.

Subject to any restrictions in its articles, a CO company may carry on any lawful business whether in or outside Anguilla. A CO company may not carry on the business of banking, trust business, insurance or company management unless licensed under the OBTCO, the IA or the CMA.

A CO company is either a domestic company or a non-domestic company. A non-domestic company is a company which does not maintain a physical presence or staff in Anguilla or which does not engage in any revenue generating activities in Anguilla.

A CO company must have a registered office and a registered agent in Anguilla, notice of which must be filed with the

Registrar.

The registered office of a non-domestic company must be provided by, and the registered agent must be, a licensee under the CMA or the TCOBA.

To ensure that CO companies do not remain on the Register without a registered agent, the CO specifies a procedure to be followed where a registered agent wishes to resign or has his licence revoked or dies. If the CO company does not appoint a new registered agent in the place of the registered agent who has ceased to act, it will be struck from the Register by the Registrar.

If the shares of a CO company are or were part of a distribution to the public that company is a public company.

Public companies are required to file audited accounts on an annual basis. A person is only eligible for appointment as an auditor if he is a member of an accountancy body recognised by the Registrar.

The CO provides for the continuation of companies into and out of Anguilla.

Foreign companies

A foreign company which carries on business in Anguilla must register with the Registrar as a foreign company.

9.3.1.4 ***International Business Company Ordinance 1994 ("IBC Ordinance")***

The IBC Ordinance provides for the incorporation, administration and operation of IBCs in Anguilla and ancillary matters such as financial disclosure, insolvency and winding up.

An IBC must not:

- carry on business with persons resident in Anguilla;
- own an interest in real property in Anguilla;
- carry on the business of banking, trust business, insurance or company management unless licensed under the OBTCO, the IA or the CMA; or
- carry on the business of providing the registered office or registered agent for companies incorporated in Anguilla.

The IBC Ordinance permits a number of activities, which could be construed as carrying on business with a person resident in Anguilla, but which are ancillary to its main activities, to be excluded from the definition. For example, operating a bank account in the jurisdiction or preparing and maintaining books and records in the jurisdiction are permitted.

An IBC may only be incorporated as a company limited by shares.

There is no requirement to file with the Registrar particulars of shareholders in or directors of an IBC. There is, however, a system for the optional filing of such particulars. On opting to file particulars of shareholders and directors, any changes must be notified to the Registrar. An IBC may elect not to continue filing particulars of shareholders and directors at any time.

An IBC is not required to have its accounts audited.

An IBC must have a registered office and a registered agent in Anguilla, notice of which must be filed with the Registrar.

The registered office of an IBC must be provided by, and the registered agent must be, a licensee under the CMA or the TCOBA.

To ensure that IBCs do not remain on the Register without a registered agent, the IBC Ordinance specifies a procedure to be followed where a registered agent wishes to resign or has his licence revoked or dies. If the IBC does not appoint a new registered agent in the place of the registered agent who has ceased to act, it will be struck from the Register by the Registrar.

9.3.1.5 ***Limited Liability Company Ordinance 1994 ("LLC Ordinance")***

The LLC Ordinance as amended provides for the formation of companies with a limited life. The LLC Ordinance is based on the legislation in force in the US State of Delaware. LLCs are used to provide fiscal transparency.

An LLC has the same rights, powers and privileges as an individual, and LLC is normally formed for a limited period, but is not required to be.

An LLC must have a registered office and a registered agent in Anguilla, notice of which must be filed with the Registrar. An LLC may not carry on the business of banking, trust business, insurance or company management unless licensed under the TCOBA, the IA or the CMA. The registered office of an LLC must be provided by, and the registered agent must be, a licensee under the CMA or the TCOBA.

To ensure that LLCs do not remain on the Register without a registered agent, the LLC Ordinance specifies a procedure to be followed where a registered agent wishes to resign or has his licence revoked or dies. If the LLC does not appoint a new registered agent in the place of the registered agent who has ceased to act, it will be struck from the Register by the Registrar.

LLCs have managers rather than directors. The manager's responsibilities are as specified in the agreement creating the LLC.

An LLC is not required to prepare accounts.

9.3.2 **Regulations, rules and guidance notes**

9.3.2.1 ***Companies and IBCs***

The following Regulations are in place in relation to CO companies, IBCs and LLCs:

- the Companies Regulations 1994 (CO companies);
- the Companies Regulations 1998 (CO companies);
- the International Business Companies Regulations 1994 (IBCs);
- the International Business Companies Amendment Regulations 1994 (IBCs); and
- the Limited Liability Company (Fees) Regulations 1994.

Pursuant to section 16 of the CRO, the Registrar issued guidelines in 1998 which included matters such as the filing of documents in electronic form, the authentication of electronic documents and the payment of fees. Non-compliance with the Guidelines may result in the revocation of authorisation by the Registrar.

9.3.3 **Supervision - systems and procedures**

9.3.3.1 ***Regulatory structure***

The Registrar is supported by a Deputy Registrar and four administrative staff. The Registry is part of the FSD and the Registrar reports to the Director of Financial Services.

The Registrar has responsibility under the CRO for the authorisation of persons wishing to file documents in electronic form under the ACORN system. This process is covered in the section of this Report on company service providers.

As the Registrar's role is not a regulatory one, there is little day-to-day supervision of CO companies, IBCs or LLCs. Rather the Registrar's primary supervisory responsibility is ensuring compliance with all statutory provisions contained within the various pieces of corporate legislation, including enforcement of all statutory requirements imposed by law.

9.3.4 **Enforcement - systems and procedures**

9.3.4.1 ***Introduction***

The CO, the IBC Ordinance and the LLC Ordinance all contain a number of enforcement powers. These are described below.

9.3.4.2 ***Inspection***

The Registrar may apply to the court for an order directing that an investigation be made of a CO company, an IBC or an LLC.

9.3.4.3 ***Striking off***

A CO company can be struck off by the Registrar if:

- it fails to send in any returns, documents or prescribed fee;
- it has not commenced business within three years after incorporation; or
- the Registrar is satisfied that it has ceased to carry on business or is not in operation.

An IBC can be struck off by the Registrar if:

- it fails to file any return, notice or document required to be filed under the IBC Ordinance;
- it fails to pay any fee or penalty required to be paid under the IBC Ordinance or under any Regulations made under the IBC Ordinance; or
- it carries on business in breach of the IBC Ordinance.

An LLC can be struck off by the Registrar if:

- the LLC contravenes the LLC Ordinance; or
- the Registrar is satisfied that it has ceased to carry on business.

9.3.4.4 ***Winding up***

The Registrar may petition the Court under the CO for the winding up of a CO company, however the grounds for doing so are limited and do not contain an ability to do so on just and equitable grounds, or in the public interest.

Where a voluntary winding up of a company is in progress the Registrar may petition the Court for the winding up to continue under the supervision of the Court. There are no similar powers under the IBC Ordinance.

The Registrar does have power to apply to the Court for the winding up of an IBC Ordinance on just and equitable grounds.

There is power in the LLC Act for the manager or a member to apply to the Court to dissolve an LLC. Dissolution may also occur if the Court thinks fit.

9.3.5 **Public availability of information**

9.3.5.1 ***CO companies***

In respect of CO companies, the documentation held by the Registrar available for public inspection includes:

- the articles of incorporation of the company;
- any other articles, for example of merger, dissolution or continuation;
- all annual returns filed by the company, which include a list of the directors, officers and shareholders of the company; and
- any resolutions altering or modifying the articles.

In the case of a public company or company carrying on a restricted business the audited accounts must be filed and are available for public inspection.

9.3.5.2 ***IBCs***

In respect of IBCs, the following documentation is held by the Registrar and is available for public inspection:

- the articles of incorporation of the IBC;
- any other articles, for example of merger, dissolution or continuation;
- any resolutions concerning an amendment to or modification of the memorandum or articles including, for example,

changes of registered office or registered agent and reductions in capital; and

- copies of any registers which the IBC has opted to file with the Registrar.

9.3.5.3 ***LLCs***

The certificate of formation of an LLC and any certificates of amendment, cancellation, merger or consolidation must be filed with the Registrar and, by virtue of section 13 of the CRO, are available for public inspection.

The certificate of formation sets out the name of the LLC, the address of its registered agent, the date of the proposed dissolution of the LLC, if any, and any other matters that the members determine.

9.3.6 **Non-public information**

Information held on the register of members held at the company's registered office is not open to the general public.

In the case of an IBC the share register must be kept at the registered office. All other books and records may be kept at such place, within or outside Anguilla, as the directors resolve. Where such a resolution is made there is no requirement for a written record of the location of the books and records to be kept at the registered office.

A member of an IBC has a right in furtherance of a "proper purpose" to inspect the share register and the other records and documents required to be kept by an IBC. There is no public right to access.

A member of an LLC has the right to inspect certain documents of an LLC provided that the request is reasonably related to his interest as a member of the LLC. Members of the public are not entitled to inspect any documents of an LLC other than those filed with the Registrar.

9.3.7 **Directors**

9.3.7.1 ***CO companies***

The CO provides for the management of CO companies. There are provisions concerning the duties and powers of directors.

Section 63 enables the Registrar to make application to the Court for an order that an individual is unfit to be concerned in the management of a company.

9.3.7.2 ***IBCs***

An IBC must have one or more directors, the first of whom is appointed by the incorporators. Corporate directors are permitted. An IBC is not required to maintain a register of directors nor to file details of its directors with the Registrar.

9.3.7.3 ***LLCs***

An LLC may have a manager, but this is optional.

9.3.8 **Beneficial ownership**

There is no requirement under either CO, the IBC Ordinance or LLC Ordinance for the beneficial owners of shares in a company or IBC to be notified to the Registrar. There is also no requirement for licence holders authorised to file documents in electronic form to determine the beneficial ownership of the companies they incorporate.

There is however a requirement for sub-agents of persons authorised to file documents in electronic form to notify the licence holders who have appointed them of the beneficial owners of companies they have incorporated.

In addition to the above, section 252 and 258 of the CO, section 100a of the IBC Ordinance and section 71a of the LLC Ordinance provides the Registrar of Companies with the ability to investigate and enquire into the ownership or control of a share by way of Court order.

LLCs do not have shares, the members make a contribution. There is no requirement for the Registrar to be notified of the person, if any, on whose behalf a contribution has been made.

9.3.9 **Bearer shares**

Subject to any limitations in its memorandum or articles of association, a CA company can issue share warrants to bearer but cannot issue bearer shares. An IBC can issue bearer shares.

There is no requirement for IBCs to file details of shareholders and it is therefore impossible to ascertain the proportion of IBCs which have issued bearer shares.

There is no provision for bearer shares under the LLC Ordinance.

9.3.10 **Insolvency**

Part IV of the CA provides for the winding up of CO companies.

The IBC Ordinance details provisions for the winding up and dissolution of solvent IBCs. An insolvent IBC is wound up in accordance with the provisions of the CO.

9.4 **Issues and recommendations**

9.4.1 **Introduction**

We have not undertaken a detailed review of the CO, the IBC Ordinance or the LLC Ordinance as this is beyond our TOR. Therefore, our specific comments and recommendations concerning these Acts should not be taken as being the only amendments which may be required. However, we have reviewed those aspects of the legislation which bear directly on our TOR and taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

From our overview it is clear that the CO, which was enacted in 1994 and amended in 1998, is a modern and comprehensive piece of legislation containing most of the features which we would expect to find. The legislation is supported by a modern Companies Registry. We are of the opinion that the CO is broadly compliant with the good practice standards set out in the Guidance Notes. However, given that, as stated in the Guidance Notes, a review of Company Law as a whole is beyond the scope of this review, there are specific areas which we have not reviewed but which we consider should be subject to a more thorough review. These are not referred to in our report but include:

- the issue of prospectuses; and
- insolvency.

Although the IBC Ordinance is similar to legislation found in a number of other jurisdictions, it too was substantially amended in 1998 and is in line with many of the good practice standards. In particular, the IBC Ordinance was amended:

- to provide that a person disqualified to act as a director of a CO company may not act as a director of an IBC; and
- to provide the Registrar with the power to apply to the Court for the appointment of an inspector.

Nevertheless, there remain some deficiencies with the IBC Ordinance which are addressed in this Report. Consequently, we do not consider that it fully complies with the good practice standards contained in the Guidance Notes.

The LLC Ordinance was also substantially amended in 1998 and brought into line with many of the good practice standards.

Given the limitations imposed upon us by the TOR, we have not undertaken a full review of either the IBC Ordinance or the LLC Ordinance. In the circumstances, our specific recommendations should not be considered to be exhaustive.

9.4.2 **Companies**

9.4.2.1 ***Public and publicly traded companies***

The preamble to the OECD Principles states that "The Principles focus on publicly traded companies". Similarly, we consider that the G22 Report and the IMF Guide are primarily focused on public and publicly traded companies.

Public companies under both the CO and IBC Ordinance can be publicly traded and we consider that, where they are so traded, they should be subject to the OECD Principles, together with the G7 and IMF standards.

There are two views which can be taken of this. The first is that a stock exchange should not list a company from a jurisdiction whose companies legislation fails to meet the Principles. The second is that a jurisdiction which permits its

companies to be publicly traded should ensure that its legal framework (taking the legislation and case law together) fully meets the Principles and the G7 and IMF standards.

In our opinion, although the first view is undoubtedly correct, a jurisdiction should not rely on exchanges in other jurisdictions to "police" the Principles on its behalf. In our view, good practice dictates that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework complies with international standards. We consider that the same standards should apply where the shares of a company can be offered for sale to the public, even if those shares are not publicly traded.

Furthermore, the recommendations of the G22 Working Group on transparency and accountability include a recommendation that national standards for disclosure should reflect five basic elements: timeliness, completeness, consistency, risk management and audit and control processes.

In the circumstances, we consider that public companies registered under the CO and IBCs which are publicly traded or whose shares may be offered to the public should be subject to a legal framework which meets the Principles.

The CO does contain controls on the issue of prospectuses. For the reasons set out in the Introduction, we have not undertaken a full review of the provisions on prospectuses.

The IBC legislation should be amended to make the CO provisions on public companies applicable to those IBCs whose shares may be offered to the public or whose shares are publicly traded.

9.4.2.2 ***Private companies***

The preamble to the OECD Principles states that the Principles "to the extent that they are deemed applicable might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises".

In respect of IBCs, whose shares may not be issued to the public (which, although there is no distinction between private and public IBCs in the IBC Ordinance, we call "private IBCs") and private CO companies we have assessed those aspects of the Principles which it is reasonable to apply.

We consider that the following sections of the Principles should, in the most part, apply to private CO companies and private IBCs:

- rights of shareholders (section I);
- equitable treatment of shareholders (section II); and
- responsibilities of the Board (section IV).

We consider that both the CO and the IBC Ordinance fall short of the Principles in certain respects. For example, there are inadequate provisions concerning directors' conflicts of interest and there are no insider trading or abusive self-dealing provisions.

9.4.3 **Audit**

9.4.3.1 ***Audit of accounts of public and publicly traded companies***

We consider that all public and publicly traded companies should, in line with OECD Principles, be required to prepare and submit annual audited accounts.

In the case of both public and publicly traded companies these accounts should be available to the public. This is already a requirement of the CO in respect of public CO companies. This is not the case in respect of IBCs.

The accounts of public and publicly traded CO companies and IBCs should be prepared in accordance with International Accounting Standards or an equivalent (eg US GAAP). This will require an amendment to the CO and IBC Ordinance.

9.4.3.2 ***Audit of accounts of private companies***

We do not consider that, unless it is a regulated institution, a private CO company or a private IBC should be required to prepare and submit audited accounts as the cost and burden of such a requirement would outweigh the benefits.

We consider that it is open to the shareholders in a private CO company or a private IBC to require the accounts of the company to be audited. We consider it appropriate that the choice should be the shareholders to make. Similarly it is a matter for potential creditors and others who do business with such companies to determine whether they wish to require an audit as a condition of entering into a business relationship.

9.4.4 **Directors**

We consider that a number of steps should be taken to facilitate compliance with the OECD Principles in this area.

The OECD Principles require the responsibilities of directors to be adequately set out. In many jurisdictions this is covered by common law rather than statute.

Provision should be made in legislation for the disqualification by the Court of directors who are not fit to be involved in the management of a company. This would reduce the use of so called "nominee" directors as a director could be held accountable for a failure to fulfil his duties. The concept of "nominee" directors is not recognised in the legislation and therefore it is important that effective action can be taken against those who do not exercise their fiduciary duties as directors appropriately. This approach accords with that taken in the "Review of Financial Regulation in the Crown Dependencies" (section 11.1.4).

We note that although there are no disqualification provisions in the IBC Ordinance, on an application for the disqualification of a person under the CO, the Court can take into account any circumstances it considers relevant including an offence involving fraud or dishonesty in connection with any body corporate. We take the view, therefore, that the conduct of a person as a director of an IBC can be taken into account in respect of an application under the CO. Given that a person disqualified under the CO cannot act as director of an IBC, we consider that both pieces of legislation meet good practice standards.

The LLC Ordinance does not contain similar provisions in respect of managers of an LLC. We consider that it should.

There is currently no requirement for an IBC to keep a register of directors. Although there is a system for the registration of directors of an IBC, this is optional and there is no requirement for an IBC to file details of its directors with the Registrar. In our view, every IBC should be required to keep a register of directors and file details of its directors with the Registrar. This approach is in accordance with the OECD Principles of Corporate Governance, section IV, "disclosure and transparency".

We also consider that the names of directors should form part of the publicly available information held on the companies registry.

There is also a need to address the issue of corporate directors. We consider that the use of corporate directors, whilst common in both on and offshore jurisdictions, could lead to a failure to comply with the OECD Principles concerning the responsibilities of the board and, in particular, the key functions of the board, such as reviewing and guiding corporate strategy.

It would however be inappropriate to impose a restriction on the use of corporate directors in the OTs until such time as the matter is addressed on a multi-jurisdictional basis. We therefore recommend that corporate directors should continue to be permitted until such time as the issue is addressed internationally. However where corporate directors are provided by a company service provider, the CSP should be required to ensure that the directors' duties are being properly fulfilled. This is dealt with in the next section.

In summary, in respect of directors, we recommend that:

- IBCs and the Registrar should maintain a register of directors of IBCs;
- those who provide directors by way of business should be required to take appropriate steps to ensure those directors are aware of their responsibilities and are suitable for the role; and
- provisions for the disqualification of managers on the grounds that they are not "fit to be involved in the management of a company" should be inserted in the LLC Ordinance.

9.4.5 **Beneficial ownership**

An effective way to determine beneficial ownership is through a requirement to formally disclose this to the Registrar. We recognise, however, that this approach is not always practicable. As an alternative we consider good practice is met by

requiring company service providers to be licensed and to be obliged to establish and record the beneficial ownership of the companies for whom they provide the service. Our proposals in respect of this are contained in the section on company service providers.

The requirements for establishing beneficial ownership may be met by any client verification requirements which may be contained in the Anti-Money Laundering Regulations when issued. If so, there must be a link between the companies legislation and the Anti-Money Laundering Regulations so that the regulator can enforce the requirements directly. For example, a breach of the Anti-Money Laundering Regulations could be grounds for revocation of the licence. Recommendations in relation to this are covered in the section on CSPs. The new CMA introduced after our visits, states that a breach of the Anti-Money Laundering Regulations is grounds for revocation of a licence.

9.4.6 **Bearer shares**

Bearer shares and share warrants to bearer can provide a significant level of anonymity, which may be abused by those seeking to use companies for a criminal purpose. Furthermore, fictitious bearer shares can be used to perpetrate fraud. There are, however, legitimate reasons for the use of bearer shares and the issue of bearer shares or share warrants to bearer is permitted in many jurisdictions.

In the circumstances, we do not consider that good practice requires bearer shares and share warrants to bearer to be prohibited but they must be effectively controlled to prevent abuse.

In our opinion, the issue, to an end client, of share warrants to bearer in respect of CO companies and bearer shares in an IBC is incompatible with good practice as the tracing of beneficial ownership may become impossible.

We therefore recommend that the CO and the IBC Ordinance be amended to require immobilisation of bearer shares as a condition of their issue.

9.4.7 **Registered office**

We consider that every CO company, IBC and LLC should be required to keep certain minimum information at its registered office. We consider that this should extend to the registers of members and directors.

We therefore recommend that, in order that the audit trail is not broken, every CO company, IBC and LLC should also be required to keep a written record of the location or locations where its other records are kept.

9.4.8 **Insolvency**

We consider that the insolvency and winding up provisions in the CO are inadequate as they do not contain many of the features that we would expect to see in a modern piece of insolvency legislation. Consequently, we consider that the provisions in place for dealing with insolvent CO companies or IBCs are inadequate.

The IBC Ordinance does not contain any separate winding up provisions for insolvent IBCs, applying the winding up of provisions in the CO.

Areas in which we consider that the insolvency provisions are inadequate include the following:

- there are no rescue procedures, such as the administrative and company and individual voluntary arrangement provisions; in the UK Insolvency Act 1986;
- there are inadequate provisions for the avoidance of pre-liquidation transactions, such as those made at an undervalue or which result in a preference of particular creditors;
- it is not possible for the liquidator to take action against directors who have caused the company to trade whilst insolvent (eg wrongful or fraudulent trading); and
- the cross-border insolvency provisions are inadequate.

9.4.9 **Enforcement powers**

We recommend that the Registrar should be given the express authority to apply to the Court for the winding up of a CO company and to apply for the dissolution of an LLC on the public interest ground.

We welcome your comments on this site.

Prepared 27 October 2000

10 Company service providers

10.1 Introduction

Company management business typically encompasses a number of activities, including:

- the formation of companies for clients;
- the provision of the registered office for companies;
- the provision of registered agents for companies (in those jurisdictions where the legislation provides for registered agents);
- the provision of nominee shareholders;
- the provision of director services; and
- the preparation and filing of statutory forms for companies.

In this Report we refer to those who undertake company management business as company service providers ("CSPs").

Most of the OTs have legislation which provides for the regulation of CSPs, although not necessarily covering all the above activities.

There are no international standards concerning the regulation and supervision of CSPs, a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either onshore or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of CSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide company services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed CSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the court to wind up a CSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a CSP's licence, as well as to pursue civil and criminal sanctions;
- CSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the directors of and the shareholders in a company serviced by a CSP and the beneficial owners of the shares in such a company; and
- CSPs, when providing director services, should be required to fulfil their responsibilities as directors and should not be permitted to abrogate their responsibilities through, for example, the use of general powers of attorney.

As indicated in the section on companies, the most practical and effective way of deterring the abuse of company structures and ensuring that relevant information is available to law enforcement authorities is through the regulation of CSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of CSPs in Anguilla and our recommendations concerning enhancements are set out below.

10.2 Type and scale of activity

The provision of company services in Anguilla is undertaken by licensed CSPs, their approved overseas sub-agents and licensed trust companies. Companies can be incorporated and documents filed electronically through an Internet based on-line company registration system known as "ACORN".

The Company Management Act, 2000 ("CMA") (which replaces the Company Management Ordinance 1994 ("CMO")) provides that no person, including an individual, may carry on company management business in or from Anguilla without a licence under either the CMA or the Trust Companies and Offshore Banking Act, 2000 ("TCOBA").

The Companies Registry Ordinance, 1998 ("CRO") provides that only authorised persons may file documents with the Companies Registry in electronic form. Only licensees under the CMA and the TCOBA and their appointed overseas sub-agents may be authorised persons.

As at 31 March 2000 there were 29 licensed CSPs and 27 approved overseas sub-agents.

10.3 **Factual assessment**

10.3.1 **Legislation**

The legislation relating to the regulation and supervision of CSPs in Anguilla is:

- the CMA
- the TCOBA;
- the CRO;
- the IBC Ordinance, as amended;
- the CO, as amended; and
- the LLC Ordinance, as amended.

The CMA provides for the compulsory licensing of those engaged in company management business and for their on-going supervision by an Inspector of Company Management ("Inspector") appointed under the CMA.

For the purposes of the CMA, "company management business" means the business of:

- the incorporation or forming of companies;
- the provision of registered office services for companies;
- acting as a registered agent;
- preparing and filing statutory documents on behalf of companies;
- acting as a director, manager or officer; and
- acting as a nominee shareholder.

The definition includes offering or agreeing to carry on any of the above activities with the intent to carry on business. The CMA permits the sharing of information with foreign regulatory authorities, including client information, provided the information is required for regulatory purposes and there are restrictions on further disclosure. The inspector may not pass client information to a foreign regulatory authority without a Court order authorising him to do so.

The CO, the IBC Ordinance and the LLC Ordinance provide that every CO company, IBC and LLC must have a registered office and a registered agent in Anguilla.

The registered agent of a non-domestic CO company, an IBC and an LLC must be a licensee under the CMA or the TCOBO and the registered office of such a company must be provided by a CMA or TCOBA licensee.

The CRO was enacted to provide for the keeping of registers by the Registrar and the filing of documents in electronic form. The CRO provides the statutory underpinning for the ACORN company registration system.

The CRO provides that only persons authorised by the Registrar (who must be CMA or TCOBA licensees or their sub-agents), may file documents electronically using ACORN.

The CMA effects a number of changes to the CSP legislation, including the requirement that an applicant for a CSP licence must pass the "fit and proper" test before it can be licensed. The CMA requires that an application for a CSP licence must not be "contrary to the public interest" and the applicant must be appropriately qualified.

The former CMO restricted the ability of the Inspector to examine the client records of a licence holder without a Court order. However, under the CMA this restriction has been removed. As noted above, the CMA restricts the ability of the Inspector to pass client information through the regulatory gateways in the CMA without a Court order.

Responsibility for licensing decisions and enforcement action remains with the Governor.

10.3.2 **Rules, regulations and guidance notes**

There is power under the CMA for the Governor to make regulations prescribing fees, exempting any person from certain provisions of the CMA or prescribing anything required or permitted to be prescribed.

The two regulations issued under the CMO related to fees, "The Company Management (Fees) Regulations 1994" and the directors' questionnaire that applicants are required to submit.

There are no other rules or regulations currently in place in respect of licensed CSPs. However the anti-money laundering regulations and guidance notes, when issued, will apply to CSPs.

The CMA makes provision for the Inspector to issue a Code of Practice regulating the conduct of the licence holders. The CMA provides that a breach of the Code is a ground for the revocation or suspension of a licence.

With the exception of Guidance produced by the Registrar of Companies concerning the electronic filing of documents, no guidance has been issued concerning the operation of CSPs.

The FSD has advised that a detailed Code of Practice for CSPs will now be issued following the enactment of the CMA.

10.3.3 **Supervision - systems and procedures**

10.3.3.1 ***Regulatory structure***

The Governor is responsible for the licensing of CSPs under the CMA. The Registrar is responsible for the authorisation of persons under the CRO.

Day-to-day supervision of licence holders is undertaken by the Inspector. The role of Inspector is undertaken by the Director of the FSD.

10.3.3.2 ***Licensing process (CMO/CMA)***

Applicants for a licence under the former CMO and now the CMA must provide details of shareholders, directors, officers and managers, and a personal questionnaire is completed by each shareholder and director. References and recent audited accounts are also required together with a detailed business plan.

A sum equal to the intended fully paid up capital must be set aside, or a guarantee under seal given, so as to ensure the capital adequacy of the CSP following the grant of the licence.

The Inspector undertakes an assessment of an applicant and then passes the application to the Governor with his recommendation.

There were four applications for licensing in 1999, one of which was rejected.

10.3.3.3 ***Authorisation process (CRO)***

As indicated, only licensed CSPs and their sub-agents may be authorised by the Registrar to file documents with the Registry electronically through the ACORN system.

Application for authorisation is made to the Registrar who, in respect of a CSP licensee and a sub-agent, must be satisfied that the person:

- has the computer hardware and software necessary to transmit documents in a secure and reliable manner; and
- has sufficient controls and procedures in place to prevent abuse of the electronic filing procedure and to comply with the Registry guidelines.

The additional process for the authorisation of a sub-agent of a licensee is set out in the following paragraphs.

10.3.3.4 ***Sub-agents***

Under the ACORN system a licensed CSP may appoint sub-agents who, subject to authorisation by the Registrar under the CRO, are permitted direct access to the ACORN system to incorporate companies and file documents electronically. Before appointing a sub-agent, the licensed CSP is expected to undertake a due diligence exercise to confirm the fit and proper status of the sub-agent. The request to appoint the sub-agent is then submitted to the Inspector who undertakes further vetting of the sub-agent before he is authorised by the Registrar to use the ACORN system.

A licensed CSP is required to enter into a written agreement with any overseas sub-agent whom he appoints. Without this agreement the Registrar will not authorise the sub-agent to use the ACORN system.

This agreement must require the sub-agent to identify his client and undertake due diligence checks on him and to identify who the beneficial owner of the company will be.

Under the agreement, the sub-agent is required to notify the licence holder of the beneficial owner of each company formed and every change to that beneficial ownership. The information provided is covered by the Confidential Relationship Ordinance 1981.

The sub-agent must also notify the licence holder of any relevant matters which come to his attention, including adverse information about the client or beneficial owner.

The licence holder has the power under the contract to terminate it forthwith if it feels the sub-agent's due diligence has fallen below an acceptable level. We have been advised that the ACORN system allows for the immediate shutting down of a sub-agent by the licensed CSP and the Inspector or Registrar.

10.3.3.5 ***Ongoing supervision***

Off-site

CMA licensees are supervised by the Inspector under the CMA and TCOBA licensees by the Inspector of Trust Companies and Offshore Banks.

Every licensee under the CMA is required to provide the Inspector on an annual basis with:

- audited financial accounts;
- a certificate of compliance, issued by an independent auditor, that the information set out in the application for a licence, as modified by a notification of change, remains correct and gives an accurate summary of the business of the licensee; and
- such documents as the Governor may prescribe together with a certificate that he has complied with the filing requirements.

The accounts are reviewed by the Inspector. There are no other requirements to provide information on an on-going basis.

There is no direct ongoing supervision of authorised overseas sub-agents by either the Inspector or the Registrar. This role is performed by the licensed CSP.

On-site

No on-site supervision of licensees has been undertaken and whilst such inspection was possible under the CMO there was no right of inspection of client records.

With the enactment of the CMA, the Inspector now has access to client files.

10.3.4 **Enforcement - systems and procedures**

10.3.4.1 ***CMA licensees***

There are a number of enforcement powers available under the CMA.

The Governor may revoke or suspend a licence on a number of grounds including the following:

- the licence is not fit and proper;
- the licence is carrying on company management business in a manner detrimental to the public interest or to the interests of one or more companies managed by him;
- the licence is insolvent;
- the licence is in contravention of the CMA, the Codes of Conduct or the Anti-Money Laundering Regulations 2000 (when in force); and
- a shareholder, director or officer is not "fit and proper".

The Inspector, when he thinks fit or when required by the Governor, may carry out an examination of a licensee.

10.3.4.2 ***Authorised persons***

The Registrar may, under section 5 of the Companies Registry Ordinance, impose such conditions on an authorised person or an overseas agent as he considers appropriate.

The Registrar may terminate authorisation with immediate effect if he is satisfied that the person does not meet the authorisation requirements, if they fail to comply with the guidelines or if they breach any terms or conditions imposed by the Registrar.

There is also automatic revocation of authorisation if he ceases to be a licence holder under the CMA or the TCOBA.

Automatic revocation of an overseas agent's authorisation occurs if the person for whom he is acting as agent ceases to be a licence holder or if that person removes the agent's authority.

10.4 **Issues and recommendations**

10.4.1 **Introduction**

Anguilla has in place a number of regulatory provisions relating to the supervision of those engaged in company service provision. We consider this to be a positive feature of Anguilla's regulatory environment and one that exists only in a limited number of other jurisdictions. These provisions are supported by the additional requirements imposed through the introduction of the ACORN system and together they achieve a significant number of the criteria set down by the Guidance Notes.

In particular, with the exception of the minor issues detailed below, we consider that ACORN enhances rather than detracts from the regulatory environment. We certainly do not consider that it poses any additional risks regarding the abuse of companies to that experienced in other offshore centres without this online facility.

The Anguilla Government was aware that some improvement was required and sought to address this through the CMA. It is our view that the CMA ensures substantial compliance with the Guidance Notes.

We detail below a number of areas which we consider should be addressed in order for full compliance to be achieved. Given the focus Anguilla is placing upon company formation and management in the growth of its financial services sector, action to address these issues should be considered a priority.

10.4.2 **CMA**

The CMA represents an enhancement on the previous CMO.

During the review meetings in Anguilla, we highlighted the following deficiencies:

- the Code of Practice was not enforceable as a breach of it was not a ground for disciplinary action; and
- a breach of any anti-money laundering code issued was not a ground for disciplinary action.

We note that, before enactment, the CMA was amended to correct the above deficiencies

We also support the decision to amend the Bill for the CMA to permit the Inspector to access client files without a Court order as we believe that effective on-site supervision cannot take place without such access. However, we consider that the Bill for the CMA is still deficient as client information obtained by the Inspector may not be passed to an overseas regulatory authority without a Court order. A Court order may only be made if the Court is satisfied that the Inspector has produced prima-facie evidence of illegal activity or there are reasonable grounds for believing that the information will be of value in the investigation of illegal activity. We consider that in this respect the CMA still fails to meet international standards.

10.4.3 **Regulatory supervision**

10.4.3.1 ***Licensing process***

The Inspector undertakes fit and proper checks of all applicants. However the CMO itself did not formally require such a check. The only conditions which the CMO required an applicant to meet were that the applicant was qualified to carry on company management business, that the application was not against the public interest and that, in the case of a company, its paid up share capital was at least EC$ 75,000.

We therefore support the section in the CMA which places the "fit and proper" requirement on a statutory footing by amending the legislation to reflect actual practice.

Although we do not consider that "four eyes" control should be an automatic requirement for every CSP, we consider that in the majority of cases it will be appropriate. We recommend, therefore, that as part of the review process for an application, the Inspector should consider whether the business proposed to be undertaken by the applicant justifies the imposition of a requirement that at least two people will be involved in the operation of the CSP to provide support and oversight. Where a licence is granted to a CSP without requiring "four eyes" control, the Inspector should keep the situation under review as it may subsequently become appropriate for him to impose such a requirement.

10.4.3.2 ***Code of Practice***

As already stated, we consider the most appropriate method of meeting the requirements of the Guidance Notes is through the regulation and supervision of CSPs.

To facilitate the meeting of the standards identified in the guidance notes we consider that the regulatory environment should include an enforceable code of practice.

This Code of Practice should include requirements relating to:

- knowing the beneficial owner of a company on an ongoing basis;
- the retention of records in the jurisdiction;
- the suitability of directors provided by the licence holder;
- the mechanisms for ensuring the immobility of bearer shares;
- the provision of powers of attorney;
- the conduct of directors provided by licence holders;
- the segregation of client money and assets; and
- the provision of signing authorities to other persons, including shareholders and the beneficial owners of shares, to a bank account of a company where the licence holder provides director services.

The anti-money laundering regulations, when issued, will apply to CSPs. To the extent that the anti-money laundering regulations cover matters listed above, the Code may simply make adherence to those regulations, and any guidelines issued under them, a requirement under the Code of Practice so providing enforcement powers for the regulator even if no criminal

action is taken as a result of the breach.

We are pleased to note that the CMA enables the Inspector to issue a Code of Practice and we recommend that a Code is issued as soon as possible.

10.4.3.3 ***Ongoing supervision***

Once the Code of Practice is in place a programme of on-site inspections should be commenced which should allow the Inspector routine access to client files. This programme should also cover compliance with any anti-money laundering regulations and verification that the contract between the licence holder and any sub-agent is being complied with. As part of this programme, an on-site procedures manual should be developed.

Existing off-site supervision should be enhanced to include the requirement for regular compliance returns from the licence holder. This will provide information to enable on-site visits to be prioritised and identify any risks or problems which require regulator action.

The issue of staff resources is covered in the regulatory section of this report.

10.4.4 **Enforcement**

We consider that there are a number of valuable enforcement powers within the CMA.

To ensure that the regulator has the fullest range of enforcement powers possible, we consider that, in addition to his current powers, he should have the ability to:

- apply to the Court, where necessary, for injunctive or other relief to protect the clients of a formerly licensed CSP; and
- petition the Court for the winding up of a former licence holder in the public interest.

We note that the Registrar monitors unlicensed activity and can and does use his discretion under company law to investigate. Whilst the Inspector has general powers for ensuring the proper administration of the CMO and CMA, we consider that as regulator of CSPs, the Inspector's powers for conducting investigations of persons suspected of undertaking licensable activities without authorisation should be clearly defined.

10.4.5 **Insurance**

Although section 22 of the CMA (section 20 of the CMO) enables the Inspector to require a licensee to effect professional indemnity, fidelity and other insurance cover, he has not, to date, required any licensee to effect insurance cover under this section and has not issued any guidelines as to the circumstances in which licensees should effect insurance cover.

We accept that the cost of the types of insurance envisaged by this section is high and may be an unnecessary burden in some cases. Nevertheless, we consider that there is a strong argument for requiring every CSP to effect professional indemnity insurance cover and for requiring any CSP who has control over client funds to effect fidelity insurance.

However, without a greater knowledge of the business undertaken by CSPs in Anguilla, we do not consider that it would be appropriate for us to make specific recommendations as to the circumstances in which CSPs should be required to effect insurance cover nor as to the types and minimum amounts of such cover.

We recommend that the Inspector should, perhaps after taking specialist insurance advice, prepare guidelines setting out in detail the circumstances in which licensed CSPs are required to effect insurance, the type of insurance to be effected and the minimum amounts of cover required. We consider that it is appropriate for the Inspector, in preparing these guidelines, to assess whether the cost of insurance is proportional to the benefits in client protection that it would bring.

Finally, a licensee who is required to effect insurance cover should be required to satisfy the Inspector that the appropriate policies are in place on an annual basis.

10.4.6 **Bearer shares**

The issue of bearer shares to end clients without any control being exercised is contrary to good practice as it makes it difficult, if not impossible, to ascertain the beneficial owner of the company at any given time.

Whilst we are not persuaded that international practice and standards require the outright prohibition of bearer shares, we consider that their use should be strictly controlled. The appropriate method of achieving this is to regulate their issue by amendment to the IBC Ordinance. We therefore consider that the IBC Ordinance should be modified to require that bearer shares may only be issued if they are immobilised. This is dealt with in the section on companies.

The immobilised bearer share should either be retained by a licensed CSP or by someone acting on his authority. The details of the requirement should be contained in the Code of Practice.

If this cannot be achieved, consideration should be given to prohibiting the use of bearer shares.

We welcome your comments on this site.

Prepared 27 October 2000

11 Partnerships

11.1 Introduction

The legislation in all of the OTs provides for two different types of partnership: ordinary or general partnerships and limited partnerships. None of the OTs have legislation in place that provides for the formation of limited liability partnerships.

Such partnerships are separate legal entities where, unlike limited partnerships, the limited partners are permitted to take part in the management of the business which and are primarily used as vehicles for professional firms.

11.1.1 Ordinary partnerships

The ordinary partnership legislation of those OTs that have it is based upon the UK Partnership Act. Neither the UK Partnership Act nor the OT partnership legislation establishes supervisory regimes. The legislation typically sets out the rules for determining the existence of a partnership and governs, to a limited extent, the relationship between partners and between the partnership and third parties. Ordinary partnerships are not subject to registration in any of the OTs. The liability of all partners in an ordinary partnership is unlimited.

Ordinary partnerships are formed almost exclusively by domestic businesses in the OTs usually where the business is small or where the members of a particular profession are prohibited from carrying on business through a limited liability company.

As ordinary partnerships are not generally used for offshore purposes we do not consider that they fall within our TOR and we have not covered them in our review. In so far as ordinary partnerships, such as lawyers and accountants, also act as company or trust service providers their role is dealt with in those sections of this Report.

11.1.2 Limited partnerships

Limited partnerships enable the liabilities of "sleeping partners" to be limited to their capital contribution provided that they do not take part in the management of the partnership. They are used typically in investment schemes to limit the liability of investors without giving them ownership of a share in a company. They are also used in estate planning schemes.

The TOR and the Guidance Notes require us to determine whether the legislation, framework and systems in place in each OT conform to good practice having regard, in particular, to FATF and CFATF Recommendations, the OECD Principles of Corporate Governance ("the OECD Principles") and the G22 Report on Transparency and Accountability.

There are no international standards that relate specifically to the supervision of limited partnerships. We have therefore considered the appropriateness of the above general standards for limited partnerships. It is our view that:

- FATF and CFATF Recommendations that are of primary relevance to limited partnerships are those that concern "know your customer" and record keeping procedures;
- the OECD Principles are designed primarily for publicly traded corporations and are not appropriate to limited partnerships; and
- the G22 Report on Transparency and Accountability is not applicable to limited partnerships.

Due to the limited liability given to limited partners, limited partnerships are attractive offshore vehicles and, in common with all offshore vehicles, are subject to potential abuse by money launderers and other criminals. We therefore consider that good practice requires that, in the event that a limited partnership is suspected of being involved in criminal activity, the law enforcement authorities should be able to access information concerning both the limited and general partners. This approach was envisaged by the Guidance Notes.

We also consider that the business of:

- forming limited partnerships;

- providing a registered office for limited partnerships; and
- acting as a registered agent

should be regarded as financial services. As such, it is important that high standards are maintained for the protection of clients. Subject to special circumstances, we consider that good practice standards require that these activities should be regulated.

11.2 Type and scale of activity

There are two types of partnership provided for under Anguilla law, general partnerships and limited partnerships.

As at 31 May 2000 there were 4 limited partnerships registered in Anguilla.

No statistics are kept on the type of business carried on by limited partnerships in Anguilla. The objects and purposes of the partnership are usually expressed in very general terms in the memorandum and any statistics compiled would therefore not be of much value.

11.3 Factual assessment

11.3.1 Legislation

Anguilla has two pieces of legislation concerning partnerships. These are:

- the Partnership Ordinance, 1994; and
- the Limited Partnership Ordinance, 1994.

11.3.1.1 *The Partnership Ordinance*

For the reasons set out in the Introduction, we have not considered the Partnership Ordinance in this Review.

11.3.1.2 *The Limited Partnership Ordinance ("LPO")*

The LPO permits the formation and their registration by the Registrar of Companies ("the Registrar"). Limited partnerships consist of one or more general partners and one or more limited partners. The provisions are similar to the limited partnership legislation found in the US State of Delaware. The Partnership Ordinance also applies to limited partnerships except where it is inconsistent with the LPO.

The general partners carry on the business of the partnership and have the same liabilities and responsibilities as partners in a general partnership. Limited partners contribute or undertake to contribute capital to the partnership and their liability is limited to the capital that they have contributed or undertaken to contribute. To the extent that a limited partner participates in the control of a limited partnership, he is liable as a general partner to persons who transact business with the limited partnership reasonably believing that he is a general partner.

A limited partnership must have a registered office in Anguilla but it is not required to have a registered agent.

A Bill to amend the LPO had been drafted at the time of our visits and was before the House of Assembly. The Bill has now been passed. The principal changes relevant to this Report made to the LPO on the enactment of the Bill are:

- all limited partnerships will be required to appoint a registered agent;
- the registered agent of a limited partnership will be required to be a licensee under the Company Management Ordinance or the Offshore Banks and Trust Companies Ordinance (now the Company Management Act and Trust Companies and Offshore Banking Act respectively);
- the registered office of a limited partnership will be required to be provided by a licensee under the Company Management Ordinance or the Offshore Banks and Trust Companies Ordinance; and
- the Registrar will have the power in certain circumstances to apply to the Court for the dissolution of a limited partnership.

11.3.2 Rules, regulations and guidance notes

Three regulations have been made under the LPO. These provide for the use of prescribed names, fees payable under the LPO and prescribed forms.

No guidance notes have been issued concerning partnerships.

11.3.3 **The formation and registration of limited partnerships**

Persons who carry on the business of forming limited partnerships or providing the registered office for limited partnerships were not, at the time of our visits, regulated in that capacity.

However, following the enactment of the amended LPO, those providing registered office or registered agent services for limited partnerships must be persons regulated under the Company Management Act or the Trust Companies and Offshore Banking Act.

Limited partnerships must be registered with the Registrar of Companies. Registration involves filing a statement with the Registrar signed by or on behalf of the general partner and containing basic information concerning the partnership and its partners.

A partnership that is not registered as a limited partnership in accordance with the LPO is deemed to be a general partnership and every partner is deemed to be a general partner with unlimited liability.

11.3.4 **Supervision - systems and procedures**

11.3.4.1 ***Regulatory structure***

Details of the structure and resources of the Registrar and Companies Registry are provided in the section of this Report on Companies.

11.3.4.2 ***On-going supervision***

In common with other jurisdictions, there is no on-going supervision of limited partnerships.

11.3.5 **Enforcement - systems and procedures**

Previously there were no specific enforcement procedures available in respect of general or limited partnerships, although certain breaches of the LPO were offences that are punishable by a fine.

Upon the enactment of the amending Bill, the Registrar has the power to apply for the dissolution of a limited partnership on a number of grounds including the following:

- insolvency;
- refusal to comply with direction of Registrar to change the partnership name;
- fraud; and
- a breach of the Ordinance.

11.3.6 **Publicly available information**

11.3.6.1 ***Information held by the Registrar***

The information contained in the register of limited partnerships maintained by the Registrar covers the following:

- the general nature of the firm's business;
- the address of the registered office of the limited partnership in Anguilla;
- the names and addresses of the general partners; and
- the term, if any, of the limited partnership.

A limited partnership is required to submit to the Registrar changes in any of the above details.

Limited partnerships are also required to make annual returns to the Registrar. The return must confirm whether there have been any changes to the information supplied to the Registrar at registration.

The register of limited partnerships, in which each statement is registered, is open to public inspection.

11.3.6.2 ***Information held at the registered office***

The general partners of a limited partnership must keep a register containing:

- the name and address of each partner;
- the amount and dates of contributions of each partner; and
- the amount and date of any payment representing a return of any part of a partner's contribution

at the registered office of the partnership.

The registers of limited partnership interests were open to public inspection but, upon enactment of the amending Bill, this is no longer the case.

11.3.7 **Non-public information**

There are no requirements that a limited partnership keep any accounting or any other books or records.

11.4 **Issues and recommendations**

11.4.1 **Introduction**

In accordance with our interpretation of our TOR, we are required to assess whether:

- in the event that a limited partnership is used or suspected of being used for criminal purposes, the law enforcement authorities in Anguilla are able to obtain basic information concerning the partnership, such as the identity of the general and limited partners;
- the true identity of general and limited partners of limited partnerships in Anguilla has been ascertained through the usual "know your customer" procedures; and
- adequate procedures are in place to protect the interests of partnerships utilising professional service providers in Anguilla.

For the reasons set out in the following paragraphs we are of the view that at the time of our review Anguilla meets in some respects the good practice standards set out in the Guidance Notes but did not meet all of them. However, we are pleased to note that most of the deficiencies that were highlighted were met upon the enactment of the Bill to amend the LPO.

We also consider that there are some further enhancements, additional to those contained in the new ordinance and these are set out below.

Our recommendations follow.

11.4.1.1 ***Availability of information to law enforcement authorities***

The information required to be filed with the Registrar does not include details of the limited partners and their capital contributions.

The information filed is available to the public and therefore readily accessible to the law enforcement authorities in Anguilla.

We do not consider that good practice requires that information concerning the limited partners and their capital contributions should be filed at the Registry provided that the information is available in Anguilla.

The LPO required the general partners to keep a register of limited partnership interests containing the above information which is available for public inspection. The new Bill extends the records that must be kept at the registered office, but provides that none of those records are available to the public.

We do not consider that it is necessary for the records to be available to the public but, subject to Court Order, they could be accessed by the law enforcement agencies if required.

We are of the opinion that the legislative requirements prescribing the information and records to be kept in Anguilla meet good practice standards. Of course the quality of the information will be dependent upon:

- the due diligence checks undertaken with regard to partners; and
- the degree of compliance with regard to the other record keeping requirements.

These matters are addressed in the following paragraphs.

11.4.1.2 ***Application of know your customer and record keeping requirements***

In order to comply with FATF and CFATF Recommendations, we consider that persons who provide the service of forming limited partnerships for profit and those who provide registered office or registered agent services for limited partnerships should be subject to the usual know your customer and record keeping requirements.

We are advised that this will be a requirement under the Anti-Money Laundering Regulation and therefore welcome this.

Persons providing partnership services for profit will be subject to the Anti-Money Laundering Regulations as licensees under the Company Management Act or the Trust Companies and Offshore Banking Act.

It is, however, necessary to ensure that their obligations under the regulations apply to their activities as partnership service providers as well. We therefore welcome the acceptance of our recommendation in our draft report that the Anti-Money Laundering Regulations, when issued, should bring within the definition of "relevant financial business" any person who, as part of their business:

- forms limited partnerships; or
- provides the registered office of limited partnerships.

11.4.1.3 ***Regulation of professional service providers***

Subject to the recommendations we make in the previous paragraph being acted upon, all partnership service providers would be subject to regulation and Anguilla will comply with good practice standards.

11.4.1.4 ***Other areas for improvement***

The Registrar previously had no enforcement powers with respect to limited partnerships. We considered that this did not comply with good practice standards.

We note that the amended Ordinance enables the Registrar to apply for the dissolution of a limited partnership. We recommend that this is enhanced by enabling the Registrar to apply to the Court for the appointment of an inspector in suitable circumstances (for example on the public interest ground). We see this procedure as analogous to the appointment of an inspector under the Companies Ordinance.

There is no requirement that a limited partnership maintains accounting records. We consider that there should be. We recommend that all limited partnerships should, at a minimum, be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership.

We do not consider that these records should be kept within the jurisdiction provided that there is a written record of the location where the records are kept at the registered office of the limited partnership. This would ensure that in the event of a criminal investigation the audit trail is not broken.

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12 Trusts

12.1 Introduction

Trusts are commonly used in offshore structures. They typically involve settlors, trustees and beneficiaries and often involve protectors, enforcers and custodians.

The settlor of a trust [2] is the person who transfers ownership of his 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.

The trustees of a trust hold legal title to the trust property. They must keep trust property separate from their own property. 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 invite and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes.

All trusts (other than purpose trusts) must have beneficiaries who may include the settlor. The trustees must account to the beneficiaries for what they do with the trust property. The beneficiaries are entitled to enforce implementation of the trust deed. A trust may be settled without existing beneficiaries provided that a beneficiary is or beneficiaries are ultimately ascertainable.

A trust may have a protector who will typically have powers to veto the trustees' proposals or remove them. A purpose trust is a trust for a particular purpose or purposes. Most of the OTs permit charitable and non-charitable purpose trusts.

An enforcer is the person who has the power to enforce a purpose trust.

A custodian trustee holds the trust property to the order of the managing trustee.

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the TOR. The TOR therefore require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for the criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries and protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary, because a proper consideration of the above issues involve both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the "Review of Financial Regulation in the Crown Dependencies". Our recommendations concerning professional trust providers in Anguilla are contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of Anguilla are required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not, in this Report, concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

12.2 **Type and scale of activity**

There are no requirements for trusts to be registered or reported in Anguilla. There is an optional registration system but as at 31 May 2000 one charitable trust had been registered under this system.

There are consequently no definitive statistics available concerning the type and scale of the trust business in Anguilla. However, as a result of offsite discussions with trust service providers, the FSD believes that there are approximately 43 trusts administered in Anguilla holding about US$37 million in assets. The FSD understands that approximately two thirds of the trust business is sourced from North America.

From its discussions with trust service providers, the FSD understands that trusts are mainly used for asset protection, estate and succession planning and employee benefit schemes.

12.3 **Factual assessment**

12.3.1 **Legislation**

The principal legislation relating to trusts in Anguilla is:

- the Trusts Ordinance, 1994; and
- the Fraudulent Dispositions Ordinance, 1994.

12.3.1.1 ***The Trusts Ordinance ("TO")***

The TO makes general provision for trusts in Anguilla and provides for the duties and powers of trustees.

Charitable and non-charitable purpose trusts are provided for and permitted by the TO. In the case of non-charitable purpose trusts section 15(1)(c) of the Ordinance requires that the terms of the trust provide for the appointment of a protector who has the power to enforce the trust and, subject to its terms, owes a fiduciary duty to the beneficiaries of the trust or to the purpose for which the trust was created. There is no restriction on who may be a protector.

Section 63 of the TO covers the exclusion of foreign law. It provides that an Anguilla trust will not be void or set aside because a foreign jurisdiction does not recognise the concept of a trust or because the trust avoids or defeats any rights conferred by a foreign law upon a person by reason of personal relationship or by way of forced heirship. This section therefore permits the creation of "forced heirship" trusts which are commonly utilised by settlors from jurisdictions where the law requires assets in a deceased's estate to be distributed in accordance with a particular formula. By settling his assets into a forced heirship trust, a settlor attempts to leave his assets according to his or her wishes rather than in accordance with the formula stipulated by the law of his jurisdiction.

A number of other jurisdictions have similar legislation facilitating the creation of forced heirship trusts.

12.3.1.2 ***The Fraudulent Dispositions Ordinance ("FDO")***

The FDO facilitates the use of Anguilla trusts for asset (or creditor) protection by repealing the Statute of Elizabeth, which prevents the use of trusts to defeat creditors.

The Ordinance provides that a disposition of property made with an intent to defraud and transfer at an undervalue is voidable by a creditor who is prejudiced provided that proceedings are commenced within three years of the date of the disposition.

12.3.2 **Regulations, rules and guidance notes**

The only regulations made under the TO are the Trust (Fee) Regulations, 1994. These detail the fees to be paid if a trust is registered under the optional registration system.

There are no other relevant regulations, rules or guidance notes specifically relating to trusts.

12.3.3 Supervision and enforcement - systems and procedures

In common with other jurisdictions, trusts are not subject to regulation by a regulatory authority. There is, therefore, no requirement for trustees, beneficiaries, custodians or protectors of Anguilla trusts to be notified to any central authority.

Trustees do, however, have a number of duties imposed on them under the TO and duties imposed on a trustee under English common law would almost certainly be imposed on trustees by the courts in Anguilla.

Section 68 of the TO provides for the optional registration of trusts with the Registrar of Companies ("the Registrar"). Where a trust is registered, a certified copy of the instrument creating it is held by the Registrar. The copy may be inspected by the trustee or by someone authorised in writing by him, but is not available for public inspection.

12.4 Issues and recommendations

12.4.1 Introduction

Trust legislation in Anguilla is similar to the trust legislation in a number of other jurisdictions, including England. In general, we do not consider that there are any particular features of the TO that are likely to lead to trust structures in Anguilla being any more or less attractive to criminals or money launderers than trusts in other jurisdictions.

12.4.2 Preventing the abuse of trusts

As indicated in the Introduction to this section, we consider that the most practical and effective way to prevent the abuse of trusts is through the regulation of trust service providers. We consider that all persons providing trust services should be regulated. Our recommendations concerning this are set out in the next section. We do not consider that any changes to the TO are required to support this.

We are concerned, however, that the use of purpose trusts may be open to abuse. Purpose trusts have no beneficiaries to take action against trustees who are in breach of their duties and there is therefore a possibility of abuse by the trustees.

We note that under the TO, however, non-charitable purpose trusts are permitted only where a protector is appointed. This will reduce the risk of abuse as the activities of the trustee will be supervised by the protector and the opportunity for misuse of trust assets by the trustees will be limited. We consider that this protection would be enhanced if the TO also required that at least one of the trustees of a purpose trust was a licensed trust service provider. We recommend that the TO should be amended accordingly.

12.4.3 Establishing the true owner of trust assets

In general, beneficial ownership of assets held in an express trust may be clear and ascertainable. However, this may not necessarily be the case for a discretionary or purpose trust or where the trustees may exercise discretionary powers.

We consider that, in the case of trusts administered by a professional trust service provider, law enforcement and regulatory authorities must, in appropriate circumstances, be able to identify the settlor, trustees, beneficiaries, protector and custodian and have access to the trust instrument and other relevant documentation concerning the trust.

This requires that the relevant documentation and information is kept within the jurisdiction. In respect of trust service providers, this is covered in the next section. This is not a general trust issue and we do not, therefore, consider that the TO requires any amendment in this respect.

12.4.4 Anti-money laundering systems

In our opinion, international standards require that professional trust service providers should be required to put in place effective anti-money laundering measures, including know your customer, record keeping and staff training procedures.

Our recommendations concerning this are in the sections on money laundering and trust service providers.

We do not consider that it is appropriate to deal with this matter in the TO as the TO is not supervisory in nature.

12.4.5 Transparency of financial arrangements

The Guidance Notes indicate:

- that basic financial information relevant to the activities of trusts should be available to law enforcement and regulatory authorities; and

- that trustees should, ideally, be held accountable to beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector, where applicable.

We are further asked to consider in what circumstances it would be appropriate for accounts to be produced, whether accounts should be made public, in which circumstances abbreviated accounts might be acceptable and in which circumstances the requirement to produce accounts should not be applied.

We consider that professional trust service providers should be required to maintain proper financial records and that these should be available for inspection by the protector and beneficiaries (where appropriate). We also consider that these records should be available to law enforcement authorities where required in a criminal investigation. Our recommendations concerning this are contained in the next section of this Report.

However, we do not consider that trust accounts should be made public as they are private arrangements. Furthermore we consider that requiring the preparation of accounts and their subsequent audit may be regarded by some clients as an unnecessary cost burden. In our view it should be for the client to determine whether he wishes accounts to be prepared and audited. It is not the role of legislation to impose it. Nevertheless we believe that the preparation and where appropriate, auditing of trust accounts, is of benefit as it reduces the risk of misappropriation of trust assets.

12.4.6 **Removal of impediments to asset tracing and seizure**

This is considered further in the section on money laundering.

There is nothing in the legislation to prevent a "flee" clause being included in a trust deed, the effect of which may be to frustrate the seizure of assets emanating from a criminal source.

We therefore recommend that as flee clauses are an issue of general application, trust legislation should be amended to restrict their use.

12.4.7 **Asset or creditor protection trusts**

The Guidance Notes also require us to consider whether the claims of creditors in the OTs can be defeated through trust structures. The relevant legislation in Anguilla is the FDO which enables the establishment of asset protection trusts.

We have reviewed the FDO. The Ordinance does allow a creditor to challenge a fraudulent disposition within a period of three years from the date of the disposition. We are of the opinion, however, that a three year limitation period is insufficient and that a six year limit should be introduced in accordance with the standard set by other jurisdictions.

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2 The descriptions of settlors, trustees, beneficiaries, protectors, enforcers and custodians are based on those set out in the "Review of Financial Regulation in the Crown Dependencies" which we consider provide excellent summaries. Back

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Prepared 27 October 2000

13 Trust service providers

13.1 Introduction

There are no international standards concerning the regulation and supervision of trust service providers ("TSPs"), a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either on or offshore regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of TSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide trust services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed TSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the Court to wind up a TSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a TSP's licence, as well as to pursue civil and criminal sanctions;
- TSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the settlor, beneficiaries, protector and the custodian (where applicable) of a trust and to obtain a copy of the trust instrument;
- law enforcement and regulatory authorities should be able to access financial information relevant to the activities of trusts administered by a TSP; and
- trustees should be held accountable to the beneficiaries and settlor, and the protector, where applicable, by preparing regular accounts, where appropriate.

As indicated in the section on trusts, the most practical and effective way of deterring the abuse of trusts and ensuring that relevant information is available to law enforcement authorities is through the regulation of TSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of TSPs in Anguilla and our recommendations concerning enhancements is set out below.

13.2 Type and scale of activity

Every company that carries on trust business in or from within Anguilla must be licensed under the Trust Companies and Offshore Banking Act 2000 ("TCOBA") previously the Offshore Banks and Trust Companies Ordinance, 1991 ("OBTCO"). There are currently three licence holders under this Ordinance, only one of which undertakes trust business.

Trust business is defined under the TCOBA as the business of acting as a trustee of property.

Only a company registered or incorporated in Anguilla can be licensed to undertake trust business. Therefore, individuals and partnerships are excluded from carrying on trust business apart from an attorney at law in so far as he is engaged in trust business solely in the practice of law.

13.3 Factual assessment

13.3.1 Legislation

The legislation governing the regulation of trust business is the TCOBA which was passed by the House of Assembly and assented to by the Governor on 24 July 2000.

The TCOBA covers both offshore banking and trust companies. In this section we are concerned only with those provisions of the TCOBA that relate to trust companies. The legislation provides for the licensing of companies that carry on trust business.

Every company carrying on trust business must be licensed as a trust company under the TCOBA, unless it is a domestic bank holding an offshore banking licence.

Trust licences are either general or restricted. A general trust licence enables a trust company to carry on trust business without any restrictions. A trust company holding a restricted trust licence must not undertake trust business for persons other than those listed in any undertaking accompanying the application for the licence.

Upon granting a general trust licence to a company, the Governor may include in the licence one or more wholly owned subsidiaries of the company, authorising them to carry on the type of trust business specified in the application. The Governor may also subject them to whatever terms and conditions he considers necessary.

Areas covered by the TCOBA include:

- granting, surrender and revocation of trust company licence;
- minimum capital requirement for licensee;
- control of appointment of directors (except a bank licensed by the ECCB);
- appointment of an Inspector of Trust Companies and Offshore Banks ("the Inspector");
- returns of a licensee;
- auditing of accounts;
- confidentiality and regulatory gateways; and
- professional indemnity insurance cover against risks such as negligence and employee dishonesty.

The TCOBA effects a number of changes to the previous OBTCO, including the requirement that an applicant for a TSP licence must pass the "fit and proper" test before it can be licensed.

The Bill for the TCOBA, as originally drafted, restricted the ability of the Inspector of Trust Companies and Offshore Banks to examine the client records of a licence holder without a Court order. However, following our first review during which the weaknesses of the draft legislation were discussed, the Bill for the TCOBA was amended to remove this restriction. We welcome this change, however by virtue of section 31(5) the information cannot be passed on to any other person without a Court order.

Responsibility for licensing decisions and enforcement action remains with the Governor under the new Act.

13.3.2 **Rules and Regulations**

Details of the regulations made under the OBTCO are contained in the section of this Report on banking.

13.3.3 **Guidance**

No guidance was specifically issued under the OBTCO relating to trusts or has yet been issued under the TCOBA.

Guidance notes were issued in 1994. These set out the criteria which need to be satisfied before a licence would be granted.

13.3.4 **Supervision - systems and procedures**

13.3.4.1 ***Regulatory resources***

Responsibility for the licensing and supervision of trust companies rests with the Governor.

Day-to-day supervision of trust companies is undertaken by the Inspector appointed under the TCOBA. This role is fulfilled by the Director of Financial Services.

13.3.4.2 ***Application process***

Application is made to the Governor via the Financial Services Department. The Inspector reviews the application, makes such further enquiries and undertakes such checks as he considers appropriate and passes the application to the Governor with a recommendation for approval or otherwise.

In addition to the criteria set out in the Guidance Notes, before granting a licence the Governor must also be satisfied that:

- the application is not against the public interest; and
- the applicant is fit and proper to carry on trust business.

An application form is prescribed by Regulation. Applicants for a licence are required to include information on themselves, their authorised agent, and evidence of appropriate trust business experience. A business plan is also required.

Exemptions from the need to supply certain details are granted for applicants for a restricted trust licence including:

- names and addresses of all officers and managers;
- annual accounts of holding company for previous three years; and
- statement of assets and liabilities at the end of the month prior to the submission of the application.

13.3.4.3 ***Principal office and authorised agent***

Under section 20 of the TCOBA, a trust company must have a principal office in Anguilla and two authorised agents approved by the Governor (who must be individuals). The functions of the authorised agents are to act as representatives of the licence holder, to ensure compliance with any statutory requirements and to act as intermediaries between the licensee and the Governor or the Inspector.

13.3.4.4 ***Ongoing supervision***

Off-site supervision

Under the TCOBA every general and restricted trust company is required to provide the Inspector on an annual basis with audited financial accounts within six months of its year end.

The Inspector also conducts regular meetings with the licence holder. However, these tend to be of an informal rather than structured nature.

We understand that the Inspector has not requested any licensed TSP to effect insurance under section 34 of the TCOBA and that no guidelines exist for determining in what circumstances insurance will be required.

On-site supervision

As there is only one active trust company, the Inspector has not considered it necessary to undertake an on-site inspection programme.

13.3.5 **Enforcement - systems and procedures**

There are a considerable number powers of enforcement available under the TCOBA.

If the licensee ceases to carry on trust business, becomes, or appears likely to become insolvent, is carrying on business in a manner detrimental to the public interest, the interests of the beneficiaries of any trust, or to the interests of its creditors, has contravened any provision of the TCOBA, the Code of Practice or the Anti-Money Laundering Regulations 2000 (when in force) or has failed to comply with a condition of its licence, the Governor may:

- revoke the licence;
- impose new or additional conditions on the licence;
- substitute any director or officer of the licence holder;

- appoint a person to advise the licence holder on the proper conduct of its affairs, and to make a report to the Inspector;
- appoint a person to assume control of the licence holder's affairs; or
- require the licence holder to take such action as the Governor thinks fit.

Where the Governor receives a report from a person appointed to advise the licensee or to assume control of the licensee, he may revoke the licence and instruct the Attorney-General to apply to the Court for the winding up of the licensee.

Under section 32 of the TCOBA, the Inspector may apply to the Court for a search warrant where there is reasonable ground for suspecting that an offence under TCOBA has been committed.

Before any action to revoke a licence is taken, however, the Governor must give the licence holder an opportunity to make representations.

There is power, under section 31 of the TCOBA for the Inspector to request information from any person, who on reasonable grounds, the Inspector believes is carrying on trust business in breach of the TCOBA.

13.4 **Issues and recommendations**

13.4.1 **Introduction**

Unlike a number of other jurisdictions, both on and offshore, Anguilla regulates the provision of trust service providers. Further, given the size of the sector, the regulatory and supervisory regime for TSPs is broadly in line with the requirements of the Guidance Notes.

We consider that, as there is only one active licence holder, the requirement for a detailed and formalised regulatory regime is unnecessary as the same standards of regulatory supervision can be achieved via less formal routes. Nevertheless, should the sector expand the current approach would cease to be as effective.

We detail below the areas where we consider attention is needed to ensure that Anguilla is fully in line with the Guidance Notes. Our recommendations have taken cognisance of the size of the sector and should be read in that context.

13.4.2 **Legislation**

We do not consider that the definition of "restricted trusts" in the TCOBA is clear. Under section 13 of TCOBA, restricted trust business is defined as trust business undertaken for the persons listed in the application. In this context, persons could be settlors, other trust service providers or even beneficiaries. The legislation should be amended to clarify the precise limits of the trust business undertaken.

13.4.3 **TCOBA**

The TCOBA represents an enhancement on the former OBTCO.

We note that two changes which we recommended in an earlier draft of our report have been included in the TCOBA. These are: :

- the Code of Practice should be made enforceable by making a breach of it grounds for disciplinary action, including the revocation of a licence;
- a breach of any anti-money laundering code issued should be grounds for disciplinary action, including the revocation of a licence.

We welcome this approach.

We also support the decision to amend the section in the draft Bill that would have prohibited the Inspector from having access to client files without a Court order as we believe that effective on-site supervision cannot take place without such access.

13.4.4 **Regulatory supervision**

13.4.4.1 ***International co-operation***

We consider the current gateways for co-operating with other regulators are generally good and permit the sharing of client information. However, the restriction in section 31(5) on the sharing of client information is not in line with good practice and should be removed. Although we fully support the decision to amend the TCOBA Bill to allow the Inspector to have access to client files we consider that the TCOBA should be amended to permit the Inspector to pass client information on to an overseas regulatory authority without the necessity of obtaining a Court order.

13.4.4.2 ***Application process***

The Inspector undertakes fit and proper checks of all applicants However, the former OBTCO did not formally require such a check. The only conditions that the OBTCO required an applicant to meet were that the applicant was qualified to carry on trust business and that the application was not against the public interest.

We therefore support the inclusion in the TCOBA of a section which places the "fit and proper" obligation on a statutory footing so amending the legislation to reflect actual practice.

This requirement should also include that all licence holders are subject to "four eyes" control.

Paragraph 9 of the Offshore Banks and Trust Companies Regulations 1992 provides that an applicant for a restricted trust company licence need not provide certain details, including names and addresses of its managers and officers. We consider that this prevents full vetting of the applicant occurring and should be withdrawn.

13.4.4.3 ***Role of auditor***

There is currently no provision within the TCOBA providing a gateway for the auditor to disclose information on a licence holder to the Inspector, nor is there an obligation imposed on the auditor to report certain matters or events to the Inspector.

Whilst we are advised that such communication occurs in practice we consider that a duty of reporting combined with an exemption from the general duty of confidentiality in such reporting would be valuable.

13.4.4.4 ***On-site supervision***

The Inspector has not conducted an on-site inspection of the single active licence holder. We consider that such an inspection is required to be in line with good practice as outlined in the Guidance Notes.

We note that the TCOBA, unlike the OBTCO, provides that a licence holder must give the Inspector access to the details of a customer without an order of the Court. We welcome this and recommend that on-site inspection should now commence.

13.4.4.5 ***Code of practice***

We consider that the most appropriate method of meeting the standards set out in the Guidance Notes in respect of trusts is via the regulation and supervision of the service provider.

To facilitate the meeting of these standards we consider that the regulatory environment should include an enforceable code of practice.

This code of practice should include requirements relating to:

- knowing the identity of the settlor, protector and custodian on an ongoing basis;
- knowing where possible the identity of the beneficiaries;
- verifying, so as far as is possible, the source of trust assets to ensure they are not of illegal origin;
- ensuring that those who undertake trust work are appropriately trained and competent;
- the delegation of any services provided, including provision of powers of attorney;
- the conduct of trustees provided by licence holders;
- the segregation of trust money and assets; and
- the maintenance of books and records including a copy of the trust deed and other documents relating to the trust.

Where areas in the code are adequately covered by the Anti-Money Laundering Regulations, the code should simply make adherence to those regulations a requirement under the code of practice thereby providing regulatory enforcement powers, even where there is no criminal prosecution as a result of the breach.

13.4.5 **Beneficial ownership**

The TOR require us to ascertain the means available to regulators and law enforcement agencies to obtain details of the beneficial ownership of trust assets. We consider that the trust service provider should primarily be concerned with the source of the assets settled into trust. This will require the trust service provider to carry out due diligence to verify the identity of the settlor, protector, custodian and any co-trustees. To enable verification by the regulator that this requirement is being met and to enable regulatory access to relevant information when appropriate, the trust service provider should keep the following in Anguilla:

- a copy of the trust deed and any memorandum of wishes;
- details of the settlor and the source of all assets settled into the trust;
- the identity of the protector and any custodians and co-trustees;
- the identity of any known beneficiaries;
- minutes of all decisions taken by the trustees; and
- trust accounts or, at the very least, records which would enable trust accounts to be prepared.

The above will then be available to the regulator and law enforcement agencies in the event of a criminal investigation taking place.

These requirements should either be introduced via regulation or form part of the anti-money laundering regulations and guidance notes to be issued under the "all crimes" anti-money laundering legislation.

13.4.6 **Insurance**

Although section 34 of the TCOBA enables the Inspector to require a licence holder to effect professional indemnity ("PI"), fidelity and other insurance cover, he has not, to date, required any licensee to effect insurance cover under this section and has not issued any guidelines as to in what circumstances licensees should effect insurance cover.

We accept that the cost of the types of insurance envisaged by this section is high and may be an unnecessary burden in some cases. Nevertheless, we consider that there is a strong argument for requiring every TSP to effect PI insurance cover and for requiring any TSP who has control over client funds to effect fidelity insurance.

However, without a greater knowledge of the business undertaken by TSPs in Anguilla, we do not consider that it would be appropriate for us to make specific recommendations as to the circumstances in which TSPs should be required to effect insurance cover nor as to the types and minimum amounts of such cover.

We recommend that the Inspector should, perhaps after taking specialist insurance advice, prepare guidelines setting out in detail the circumstances in which licensed TSPs are required to effect insurance, the type of insurance to be effected and the minimum amounts of cover required. We consider that it is appropriate for the Inspector, in preparing these guidelines, to assess whether the cost of insurance is proportional to the benefits in client protection that it would bring.

Finally, a licensee that is required to effect insurance cover should be required to satisfy the Inspector that the appropriate policies are in place on an annual basis.

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14 International co-operation

14.1 Introduction

A number of international standards are in place concerning the provision of co-operation between law enforcement and regulatory authorities. These include those established by international regulatory bodies such as IOSCO, IAIS and Basel, the relevant FATF/CFATF Recommendations, the "Ten Key Principles for International Financial Information Exchange" recommended by the G7 Finance Ministers in May 1998 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. These, together with good practice standards, are referred to in the Guidance Notes. We are not asked to consider international co-operation that relates to purely fiscal matters.

The principal international standards and good practice standards set out in the TOR and the Guidance Notes are that:

- there are effective statutory gateways in place through which an OT regulator can disclose confidential information concerning licensees, including client information, to foreign regulatory authorities;
- an OT regulator can, through the imposition of conditions, ensure that confidential information it discloses to a foreign regulatory authority is not onward disclosed by the foreign regulatory authority without the consent of the OT regulator;
- an OT regulator is able to safeguard the confidentiality of information disclosed to it by a foreign law enforcement or regulatory authority;
- where necessary, MOUs between an OT regulator and foreign regulatory authorities are in place and that MOUs should contain provisions for safeguarding the confidentiality of information provided;
- the law enforcement authority in an OT has a full range of powers to provide mutual legal assistance to foreign law enforcement authorities, including the obtaining of evidence and the provision of assistance at the investigation stage;
- co-operation between criminal authorities should cover all financial crimes (including, for example, insider trading and market manipulation) and not just money laundering;
- it should be possible for co-operation to be provided even if the activity under investigation takes place and/or is not an offence in the OT;
- international co-operation should extend to tracing, freezing and confiscating proceeds of crime on behalf of overseas authorities. This should be on an "all crimes" basis (including all financial crimes), as envisaged by the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990;
- no assets should be immune from seizure through asset protection trusts or flee clauses in trusts;
- law enforcement and regulatory authorities should be able to co-operate effectively with each other both domestically and abroad;
- OT regulators can, in the course of their normal duties, obtain information relating to the supervision of licensees and that this information can be disclosed to foreign regulatory authorities through the statutory gateways;
- OT regulators have powers at least equivalent to those contained in the model "Compulsory Powers Ordinance" annexed to the Guidance Notes to compel the production of information from both regulated and unregulated persons for their own regulatory purposes and at the request of foreign regulatory authorities; and
- adequate resources, including legal advice, are available to OT regulatory and law enforcement authorities for the purposes of international co-operation.

The TOR for this review require us to consider whether the legislation, systems and procedures in place in Anguilla for international co-operation conform to the above international and good practice standards.

14.2 **Confidentiality**

14.2.1 **Introduction**

Regulators are usually subject to a duty of confidentiality which may be imposed:

- under a general statute which preserves the confidentiality of information with respect to business which is of a professional nature;
- in legislation which creates or governs the regulator;
- in legislation which provides for the regulation of particular financial services; and/or
- under common law.

It is appropriate and in accordance with international standards for restrictions to be placed upon the disclosure of confidential information by a regulator. However, in order for a regulator to co-operate effectively with foreign regulatory and law enforcement authorities, there should be gateways through which he can pass confidential information.

14.2.2 **Relevant Anguillan legislation**

The preservation of confidential information in Anguilla is primarily achieved through the Confidential Relationships Ordinance, 1981 ("CRO"), as amended by the Confidential Relationships Amendment Ordinance, 1998. The CRO is of general application.

In addition, certain duties of confidentiality are imposed at common law and under those statutes which provide for the regulation of financial services.

There are statutory provisions which enable the disclosure of information to law enforcement authorities within and outside Anguilla and to foreign regulatory authorities. These are contained in the statutes which provide for the regulation of financial services in Anguilla.

For the purposes of this Report we have reviewed the CRO and the statutes listed below, all of which contain provisions relating to the preservation of confidentiality and/or to international co-operation generally:

- OBTCO ;
- IA;
- CMO;
- MLAT Ordinance;
- the Criminal Justice (International Co-operation) (Anguilla) Order 1994, ("CJICAO"); and
- the Drug Trafficking Offences Ordinance, 1987 ("DTOO"), as amended by the Drug Trafficking Offences (Amendment) Ordinance 1990.

14.2.3 **Recently enacted legislation**

A number of Bills which are relevant to international co-operation were before the House of Assembly in Anguilla at the time of our review but have since been enacted. These are:

- the Law Revision (Interim Revised Statutes Amendment) Act, 2000;
- the Criminal Justice (International Co-operation) (Anguilla) Act, 2000 ("CJICAA");
- the Proceeds of Criminal Conduct Act, 2000 ("PCCA");
- the Money Laundering Reporting Authority Act, 2000 ("MLRAA");
- the Company Management Act ("CMA"); and

- the Trust Companies and Offshore Banking Act ("TCOBA").

The Law Revision (Interim Revised Statutes Amendment) Act, 2000 makes a minor amendment to the DTOO.

Given that the Bills were tabled at the time of our visits, we have considered them for the purposes of this Report and we comment on their effect. However the timing of their enactment (they were passed by the House of Assembly and assented to by the Governor on 24 July 2000) means that we have not had an opportunity to review the final Acts and have relied upon information regarding their final content provided by the Government of Anguilla.

Finally, as discussed earlier in this Report, the ECCB has drafted a Bill for a Securities Act which is currently under consideration by the ECCB member territories. We have also considered this for the purposes of our report on international co-operation.

14.2.4 **CRO**

The CRO codifies the English common law duty of confidentiality owed by a bank to its customer, extends the duty to other professional relationships and criminalises a breach of that duty. The Director of Financial Services and his staff and the statutorily appointed regulators are all subject to the CRO.

Subject to certain exceptions set out in section 3 of the CRO, any person who divulges or attempts to divulge confidential information to a person not entitled to receive it commits an offence.

14.3 **Co-operation between regulatory authorities**

14.3.1 **Legislative gateways**

Anguilla has a number of legislative gateways which facilitate co-operation with foreign regulatory authorities. These are detailed below.

14.3.1.1 ***OBTCO and CMO***

The OBTCO and the CMO contained provisions which enabled the relevant regulator to require the production of and/or access to the books and records of a licensee and to demand information or explanations from a licensee.

Both Ordinances contained restrictions on the relevant Inspector's access to client files and information unless he obtains a Court Order or the client's consent. The restrictions have recently been removed by the Company Management Act 2000 ("CMA") and the Trust Company and Offshore Banking Act 2000 ("TCOBA").

The TCOBA and the CMA (like the OBTCO and CMO before them) contain similar restrictions on the disclosure of information concerning a licensee, an applicant for a licence, a customer of a licensee and a company managed by a licensee ("a protected person"). Taken together, they provide that the relevant Inspector and a person appointed by the Governor to assist him, must not disclose to any person information concerning a protected person which he has acquired in the course of his duties.

Each Act provides, *inter alia*, that the restriction on disclosure does not apply to a disclosure:

- required or permitted by any Court of competent jurisdiction in Anguilla; or
- made by the Inspector to a foreign regulatory authority in accordance with certain conditions set out in the Act.

The conditions which must be satisfied before information is passed to a foreign regulatory authority are that the relevant Inspector must be satisfied that:

- the foreign regulatory authority is subject to adequate legal restrictions on further disclosure; and
- that the information disclosed is reasonably required by the foreign regulatory authority for the purposes of its regulatory functions.

A foreign regulatory authority is defined as a regulatory authority which exercises functions corresponding or similar to those exercised by the Inspector of Offshore Banks and Trust Companies, the Inspector of Company Managers or the Registrar of Insurance. The gateways do not, therefore, permit disclosure to a foreign regulatory authority which only exercises regulatory functions in an area other than banking, trust companies, company management or insurance, for

example a securities regulator.

There is a restriction on the type of information which may be disclosed through the gateway described. This restriction was introduced in the TCOBA and CMA. Whilst these enable the relevant regulator to access client information for his own regulatory purposes, he is not be able to utilise the regulatory gateways to disclose the client information on to a foreign regulatory authority unless he obtains a Court Order.

14.3.1.2 ***IA***

Section 46 of the IA gives the Registrar of Insurance the power to demand documentation or information "relating to any matter connected with his business or transactions". There is no restriction on client information.

The IA contains regulatory gateways which, in all material respects, are identical to those contained in the OBTCO and the CMO, except that a policyholder is also a protected person.

14.3.1.3 ***Domestic banks***

The TCOBA does not apply to domestic banks which are regulated by the ECCB under the Banking Act, 1991 (unless they also undertake offshore banking activities).

The ECCB has stated that it lacks the powers to co-operate with regulators in other jurisdictions in respect of Anguillan domestic banks. The ECCB is currently developing amending legislation to rectify this deficiency.

However, the ECCB has also advised us that it has had no difficulty in obtaining information from Anguillan domestic banks.

14.3.1.4 ***CRO***

As stated, the CRO applies to the regulators in Anguilla. However, the CRO contains an important exemption. Section 3(2)(e) provides that the CRO does not apply to confidential information given to or received by any person in accordance with the provisions of the TCOBA, CMA or the IA.

Accordingly, the operation of the CRO is excluded for regulatory purposes where the relevant Inspector discloses information through the regulatory gateways contained in the TCOBA, the CMA or the IA.

14.3.1.5 ***Securities/investments, mutual funds, stock exchanges***

Section 47 of the draft Bill for a Securities Act proposed by the ECCB requires the Securities Commission to maintain a detailed register of persons holding licences under the Act.

However the draft Bill only permits the Securities Commission and the Securities Exchange to exchange information with each other and with other securities markets and clearing houses. There is no provision for the disclosure of information to foreign securities regulators.

14.3.1.6 ***Companies, trusts and limited partnerships***

Neither the IBC Ordinance nor the CO permit the Registrar of Companies to disclose non-public information to a regulatory or law enforcement authority.

All information held by the Registrar of Limited Partnerships is available to the public and can therefore be disclosed to foreign regulators.

Disclosure of information in respect of companies, trusts and partnerships is discussed further in earlier sections of this Report on each of these areas.

14.3.2 **Compulsory powers**

Anguilla does not yet have legislation in place which is equivalent to the Model Compulsory Powers Ordinance annexed to the Guidance Notes. However, we are advised that the Government is considering such a Bill.

14.3.3 **Memoranda of understanding**

There are no memoranda of understanding ("MOU") in place between Anguilla and any foreign regulatory authorities.

However, the Government is currently in the process of negotiating an MOU with the ECCB concerning the supervision by the ECCB of the offshore banking business of subsidiaries of domestic banks.

14.3.4 **Confidentiality of information received from foreign regulatory authorities**

There are no specific provisions which require the Director of Financial Services, the Inspector of Banks and Trust Companies, the Inspector of Company Management or the Registrar of Insurance to preserve the confidentiality of information received from foreign regulatory authorities.

14.4 **Co-operation between law enforcement authorities**

14.4.1 **Legislation**

14.4.1.1 ***MLAT Act***

The MLAT Act gives effect, in Anguilla, to the Mutual Legal Assistance Treaty concerning the Cayman Islands agreed between the UK and the USA in 1986 ("the Treaty"). The objective of the MLAT Act is to enable the provision of mutual legal assistance between the USA and Anguilla for the investigation, prosecution and suppression of criminal offences. Virtually identical legislation is in place in the other Caribbean Overseas Territories.

For the purposes of the Treaty, a criminal offence is either conduct which satisfies the dual criminality test, ie it is conduct that is punishable by imprisonment of more than one year in both Anguilla and the USA, or it is one of a number of specific listed offences which include insider trading and fraudulent securities practices.

Article 1 of the Treaty defines the scope of assistance to be provided. The Article states that mutual assistance is to be provided for the investigation, prosecution and suppression of criminal offences covered by the Treaty. With the exception of certain civil and administrative proceedings relating to narcotics, the Treaty does not extend to civil matters.

The Treaty can be used both to obtain information and evidence and for search and seizure. However information or evidence obtained cannot be used for purposes other than those stated in the request without the approval of the party to whom the request is made.

A person who divulges confidential information in conformity with a request is given immunity from any action for breach of confidentiality.

The Authority under the MLAT Act in Anguilla is the Attorney-General. The US Authority is the Department of Justice.

14.4.2 **CJICAA**

The CJICAA replaces the CJICAO and is similar to the UK's Criminal Justice (International Co-operation) Act 1990 (the "UK Act"). Like the CJICAO it gives substantial effect to the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

The provisions of the CJICAA concerning co-operation include:

- the mutual service of process, in criminal matters;
- the mutual provision of evidence in criminal matters;
- the issue of search warrants in Anguilla;
- the enforcement in Anguilla of overseas forfeiture orders in respect of drugs or drug trafficking offences; and
- extradition for drugs or drug trafficking offences.

The provision of evidence does not require dual criminality. The CJICAA contains the addition of "ship-riding" provisions.

14.4.2.1 ***PCCA***

The PCCA provides for the enforcement of external confiscation orders.

14.4.3 **Provision of co-operation**

In the case of a request for assistance emanating from the USA, a request may be made by the Department of Justice to the Attorney-General under the MLAT Treaty or by the appropriate US authority under CJICAA.

A request for assistance under CJICAA may be made by the appropriate authority of any jurisdiction by letter of request sent by that authority to the Attorney-General.

During our visits, no information was available on the number of requests for assistance under the MLAT Act. We have subsequently been advised that four requests from the US under the MLAT have been received in the last three years.

14.5 Requests to other jurisdictions for assistance in criminal and regulatory matters

Anguilla has made insufficient enquiries to other jurisdictions to assess the quality of the assistance that has been provided.

14.6 Co-operation between regulatory and law enforcement authorities

There is no specific provision in any financial regulatory legislation formally enabling the regulator to disclose matters to the police.

However, the CRO does not apply to confidential information given to or received by a police officer in execution of his duties in or outside Anguilla investigating a criminal offence alleged to have been committed in Anguilla or which, if it had been committed within Anguilla, would have been a criminal offence under the law of Anguilla.

In addition we have been advised by the FSD it does not consider there to be any legal restrictions which prevent the regulators co-operating fully with the police in Anguilla and that the level of assistance is significant. This was confirmed in our discussions with the police.

14.7 Co-operation on fiscal matters

14.7.1 MLAT Act and Treaty

Conduct which relates directly or indirectly to the regulation, imposition, calculation or collection of taxes is excluded from the Treaty with the exception of tax fraud and the wilful or dishonest making of false statements to government tax authorities (eg by submitting a false tax return). Therefore co-operation can only be provided if the offence involves these above exemptions.

14.7.2 CJICAA

The CJICAA extends to fiscal offences, except that the Governor shall not exercise his discretion where it appears that the request relates to a fiscal offence in respect of which proceedings have not yet been commenced unless:

- the request is from a Commonwealth country, or is made pursuant to a treaty to which the United Kingdom is a party and such a treaty has been made applicable to Anguilla; or,
- he is satisfied that the conduct constituting the offence would constitute an offence if committed in Anguilla.

This provision matches that contained in section 4(3) of the UK Act and means that co-operation can be provided if the above criteria are met.

14.8 Intelligence networks

Anguilla participates in the Overseas Territories Regional Criminal Intelligence System ("OTRCIS"). This system, which is operated out of Miami assists the Caribbean Overseas Territories law enforcement authorities to combat local criminality occurring in each individual Territory, as well as the threat posed by drug trafficking and organised crime including money laundering. OTRCIS provides a secure database on information relating to criminal and suspected criminal activity in the Overseas Territories.

14.9 Support

14.9.1 Resources

There are no Anguillan Government employees dedicated to the issue of international co-operation.

Legal support on matters of co-operation, both criminal and regulatory, is provided by the Attorney-General's Chambers.

14.9.2 **Egmont Group of Financial Intelligence Units**

Anguilla is not a member of the Egmont Group.

14.9.3 **White Collar Criminal Investigation Team**

Additional support is available to the police in Anguilla and the regulators through the White Collar Criminal Investigation Team ("WCCIT"). This is a joint UK/FBI team operating out of the FBI's offices in Miami. Currently two UK police officers are seconded to the team. These officers are also sworn in as police officers in each of the Caribbean Overseas Territories.

The role of WCCIT is to undertake and assist on the investigation of white collar crimes involving the US, the UK and OTs in the Caribbean.

WCCIT does not have authority to initiate investigations in respect of drugs and drug related offences. There are resources available to assist the OTs with anti-drug trafficking investigations through the drugs liaison network in the region. There is also an un-appointed Drugs Law Enforcement Adviser for the OTs available to assist with OT related drugs matters.

14.10 **Issues and recommendations**

14.10.1 **Introduction**

We consider that Anguilla is in substantial compliance with international standards concerning international co-operation. We note that effective regulatory gateways have been in place since 1998 and that the gateways do not restrict the type of information which can be passed to a foreign regulatory authority. The gateways do not enable the regulators in Anguilla to pass information directly to foreign law enforcement authorities, but the same result can be achieved by permitting the foreign regulatory authority to onwards disclose the information.

One serious weakness was the lack of provision for the enforcement of external confiscation orders in non-drugs related cases. This was very recently addressed in the PCCA and we welcome this development.

The other weakness is the restriction on providing client information to overseas regulators without a Court order.

A number of relatively minor amendments are required to existing legislation and to the PCCA if Anguilla is to comply fully with international standards.

The areas where we consider specific action is required are detailed below.

14.10.2 **Co-operation between regulatory authorities**

14.10.2.1 ***Scope of existing gateways***

The Guidance Notes require that the statutory gateways should extend to client information. The gateways in the OBTCO, the CMO and the IA did extend to client information, but only if the information was in the regulator's possession. The inability of the regulator to access client information without a Court order restricted his ability to co-operate with foreign regulatory authorities.

The enactment of the new TCOBA and the new CMA, given the relevant Inspector access to client records, the regulator will require a Court Order to disclose client information to a foreign regulatory authority.

We recommend that the new TCOBA and the new CMA are both amended to enable the regulator to disclose client information to a foreign regulatory authority without the need for a Court Order. However, we fully agree that it remains necessary for the disclosure of client information to be restricted in accordance with regulatory need and to be subject to strict conditions.

In addition, the gateways enable the relevant Inspector to disclose information to a foreign regulatory authority only if its functions are equivalent or similar to those of the Inspector of Offshore Banks and Trust Companies, the Inspector of Company Managers and the Registrar of Insurance. We consider that this is too restrictive as it prevents information being disclosed to, for example, a securities regulator. We recommend that the gateway is widened to permit information to be disclosed to foreign regulatory authorities whose functions extend beyond the scope of financial services business currently regulated in Anguilla.

We understand that gateways complying with the above recommendations have been inserted into the new Insurance Act which is currently under consideration.

14.10.2.2 ***Securities/investments, mutual funds and stock exchange***

The current restrictions on the disclosure of information contained in the draft Securities Act proposed by the ECCB do not accord with international standards and should be amended to comply with the above recommendations.

14.10.2.3 ***Compulsory powers***

The Model Compulsory Powers Ordinance was developed by the UK and discussed with the OTs at a number of Attorney-Generals' Conferences. It is designed to provide OT regulators with powers to compel the production of information from both regulated and unregulated individuals and entities in order to satisfy a request for assistance made by a foreign regulator. As regulatory requests are civil rather than criminal, they cannot generally be made under legislation which enables the provision of assistance in criminal matters. Such powers are envisaged by IOSCO and represent good practice.

In order to comply with the requirements of the Guidance Notes which, in our view, represent good practice in this area, it is essential that legislation equivalent to the Model Ordinance should be enacted as soon as possible.

We understand that a Bill has been drafted and that it has been submitted to the private sector as part of the consultative process. However, we have not been provided with a copy of the Bill for review.

We recommend that legislation equivalent to the Model Ordinance is put in place as soon as possible.

14.10.2.4 ***MOUs***

As indicated, there are no MOUs in place between regulators in Anguilla and foreign regulatory authorities.

The TOR require that MOUs are put in place where necessary. The legislation does not require MOUs to be put in place and there is no evidence that the lack of MOUs is preventing or hindering the regulators in Anguilla from co-operating with foreign regulatory authorities.

Nevertheless, we consider that MOUs are a useful tool and, where in place, facilitate the prompt exchange of information between regulators.

We recommend that the Anguillan Government considers agreeing MOUs with those regulatory authorities with whom the Anguillan regulators have more frequent contact.

We also consider that the absence of a finalised MOU between the FSD and ECCB is a weakness, particularly as two banks, currently licensed by the ECCB, are seeking offshore banking licences. If the domestic and offshore banking sectors are to continue to be regulated by two different supervisors, MOU and agreement on lead supervision must be concluded.

14.10.2.5 ***Confidentiality of information received***

The Guidance Notes require that regulators are able to safeguard the confidentiality of information provided to them by foreign regulatory or law enforcement authorities. There is no specific statutory provision concerning this.

Whilst it is arguable that information supplied to the regulator in Anguilla by a foreign regulator is covered by the CRO and by the confidentiality provisions in the TCOBA, the CMA and the IA, we consider that this is not certain.

In the circumstances, we consider that it would be advisable for clear statutory provision to be made.

We therefore recommend that, in order to facilitate international co-operation and meet international and good practice standards, specific provision for the confidentiality of information received from foreign regulators and law enforcement authorities should be enacted.

14.10.3 **Co-operation between law enforcement authorities**

14.10.3.1 ***CJICAA***

The CJICAA like its predecessor is similar to the UK Act and provides for a significant level of international co-operation. In particular, there is no requirement for dual criminality on an application from a foreign law enforcement authority to obtain

evidence in Anguilla in connection with foreign criminal proceedings.

We consider that, with the addition of "ship-riding" provisions, the new CJICAA, fully meets international standards.

14.10.3.2 ***MLAT Ordinance***

Our discussions with the US Department of Justice indicate that the Department is relatively comfortable with the operation of the Treaty in practice, although they considered the level of resources available to provide a swift response is limited.

The Attorney-General has advised us, however, that MLAT requests are dealt with very promptly. A lack of available data on the speed of response has not allowed us to verify this.

14.10.3.3 ***Restrictions on the ability to co-operate in relation to financial offences***

Given the requirement for dual criminality in relation to the exchange of information under the MLAT Ordinance, it may not be possible to provide co-operation in respect of conduct which may constitute a financial services criminal offence in the USA but which does not constitute a criminal offence in Anguilla. However, a number of matters which are not offences in Anguilla are specified in the Treaty.

As indicated above, the provision of evidence under CJICAA does not require dual criminality.

If the Department of Justice is unable to use the MLAT Ordinance to obtain evidence in Anguilla in respect of a US financial crime which is not an offence in Anguilla, it is open for an application to be made under CJICAA.

14.10.3.4 ***Tracing, freezing and confiscating of proceeds of crime***

The CJICAA provides for the enforcement of overseas forfeiture orders in drugs cases.

The PCCA provides for the enforcement of external confiscation orders in non-drugs cases and, as a result of its recent enactment, Anguilla is in substantial compliance with international standards.

However, the PCCA depends upon dual criminality and therefore does not extend to conduct which may be a financial crime in a foreign jurisdiction but which is not an indictable offence in Anguilla (for example, insider trading and market manipulation). Therefore, the provisions which permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

Compliance could be achieved by extending the range of financial crimes.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or flee clauses. Our recommendations concerning flee clauses in the section on Trusts should be considered in this context.

14.10.4 **Co-operation between regulatory and law enforcement authorities**

As indicated, there is no specific provision in any financial regulatory legislation formally enabling the regulator to disclose matters to the police.

Although the CRO does not apply to confidential information given to or received by a police officer in the circumstances outlined earlier in this Report, we note that this is not an enabling power. It simply provides that the CRO does not apply. In the circumstances, if information is confidential, other than through the application of the CRO, this exception would not assist.

Specifically, the exception to the CRO does not assist in respect of information which the relevant Inspector is required to keep confidential by virtue of the TCOBA or the CMA.

In the circumstances, we recommend that specific statutory provision is made enabling the regulators in Anguilla to disclose information to the Royal Anguilla Police Force.

In addition whilst the relationship between the regulators and the police is good, we consider that there needs to be a formal communication process whereby the police advise the FSD of the findings or investigations relating to fraud and money laundering and we recommend that appropriate procedures are put in place.

14.10.5 **Transparency in co-operation**

Discussions within and outside Anguilla indicate that the potential gateways for co-operation are not always well understood by those requesting assistance. Failure to utilise the appropriate gateway can lead to delay and the impression of a lack of co-operation.

To address this issue, we consider that the Anguilla Government should produce and publish (possibly via the World Wide Web) guidance on the international co-operative gateways for both civil and criminal requests for assistance.

We therefore recommend that the Anguilla Government should produce guidance notes for regulators and criminal authorities in other jurisdictions detailing the types of co-operation available and the appropriate procedures for seeking co-operation.

14.10.6 **WCCIT**

To facilitate the full assistance of WCCIT in relation to money laundering offences we recommend that the current exclusion of drug related matters from its scope is removed.

14.10.7 **Resources**

Whilst there are no individuals dedicated to the issue of international co-operation, there is no indication that there are insufficient resources available to provide information when requested. However, we do recommend that appropriate information monitoring procedures are put in place.

Concern was however expressed by the Royal Anguilla Police of the need for support from outside the jurisdiction in assisting with financial offences, particularly complex cases. In light of these concerns, we consider that there is a need to ensure that Anguilla is provided with adequate experienced police resources for the investigation of complex financial crime.

Prepared 27 October 2000

15 Anti-money laundering

15.1 Introduction

A number of international standards are in place setting legislative and practical measures that should be taken to combat money laundering. These are contained principally in the FATF 40 Recommendations and the CFATF 19 Recommendations, the Vienna Convention and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. We are asked to consider to what extent the OTs apply the standards set out in these documents together with those contained in the EC Money Laundering Directive (June 1991).

Our review falls into two parts. The first is a review of the legislation, regulations and guidelines in place. The second is a review of the implementation of the legislation, regulations and guidelines, especially as regards to the reporting, handling and investigation of suspicious transaction reports.

15.2 Factual assessment

15.2.1 Legislation

15.2.1.1 *Introduction*

The legislation currently in force in Anguilla dealing with money laundering is:

the Drug Trafficking Offences Ordinance, 1987 ("DTOO"), as amended by the Drug Trafficking Offences (Amendment) Ordinance, 1990;

- the Law Revision (Interim Revised Statutes Amendment) Act, 2000;
- the Criminal Justice (International Co-operation) (Anguilla) Act, 2000 ("CJICAA");
- the Proceeds of Criminal Conduct Act, 2000 ("PCCA"); and
- the Money Laundering Reporting Authority Act, 2000 ("MLRAA").

The Law Revision (Interim Revised Statutes Amendment) Act, 2000 makes a minor amendment to the DTOO.

Given that the Bills were tabled at the time of our visits, we have considered them for the purposes of this Report and we comment on their effect. However the timing of their enactment (they were passed by the House of Assembly and assented to by the Governor on 24 July 2000) means that we have not had an opportunity to review the final Acts and have relied upon representations regarding their final content given by the Government of Anguilla.

15.2.1.2 *DTOO*

15.2.1.3 *Offences*

The DTOO was enacted to implement the drug trafficking aspects of the Vienna Convention in Anguilla. The following money laundering offences were created by the DTOO:

- assisting another to retain the benefit of drug trafficking (section 22); and
- prejudicing an investigation (section 31).

The *mens rea* for the offence of assisting another to retain the benefit of drug trafficking is "knowing or having actual suspicion" that the person assisted or is carrying on or has carried on drug trafficking.

The offence provisions apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit offences under the Act.

15.2.1.4 *Other provisions*

Sections 5-8 of the DTOO enable the Court to confiscate the proceeds of drug trafficking and sections 10-13 give the Court the power to make restraint orders and charging orders.

Sections 23 and 23A of the DTOO establish procedures for registering at Court and enforcing foreign confiscation orders made by the court of a country designated by the Governor. An Order has been made under the DTOO and the list of countries designated is comprehensive.

The DTOO also provides for production orders (section 24) and search warrants (section 25).

Section 22 of the DTOO provides for reporting suspicious transactions to a police officer. As enacted, the Bills provide that suspicious transaction reports under the DTOO will be made to the Money Laundering Reporting Authority established under the MLRAA ("the Reporting Authority").

Section 23 of the DTOO provides that, if a person makes a disclosure to a police officer:

- that disclosure shall not be treated as a breach of any duty of confidentiality imposed by contract; and
- provided the disclosure is made in accordance with the section, he does not commit any offence in respect of any act done in contravention of the section.

Whilst this section does not, of itself, protect a person from the provisions of the Confidential Relationships Ordinance, this is provided for by section 3 of the MLRAA.

As its name suggests, the DTOO is concerned with drug trafficking only and its money laundering provisions are therefore limited to those dealing in the proceeds of the underlying (or "predicate") offence of drug trafficking.

15.2.1.5 ***CJICAA***

15.2.1.6 ***General provisions***

The CJICAA enables Anguilla to co-operate with other countries in criminal investigations through mutual legal assistance. This is discussed further in the section on International Co-operation.

The CJICAA also provides for the enforcement of overseas forfeiture orders in drug cases.

15.2.1.7 ***Drug trafficking offences***

CJICAA contains the offence of concealing or transferring the proceeds of drug trafficking and the offence of acquiring another person's proceeds of drug trafficking. The latter offence does not extend to possessing or using another's proceeds of drug trafficking.

The *mens rea* for concealing or transferring or acquiring the proceeds of another's drug trafficking is "knowing or having reasonable grounds to suspect" that the property represents the proceeds of another's drug trafficking.

The offence provisions of the CJICAA apply to "persons". A "person" includes an individual and a corporate body. Therefore both may commit offences under the CJICAA.

15.2.1.8 ***Seizure of the proceeds of drug trafficking***

CJICAA enables a customs officer or police officer to seize and detain cash (exceeding EC$ 10,000 or its equivalent in another currency) which is being imported into or exported from Anguilla and which the officer has reasonable grounds for suspecting represents the proceeds of drug trafficking.

The CJICAA extends the seizure provisions to the proceeds of all crimes, not just drug trafficking.

15.2.1.9 ***PCCA***

Money laundering offences in Anguilla until recently were restricted to laundering the proceeds of drug trafficking. Money laundering extends to the proceeds of "all crimes" with the enactment of the PCCA.

The money laundering provisions in the PCCA apply to "criminal conduct" which is defined as an indictable offence or conduct taking place outside the jurisdiction which would constitute an indictable offence if it had occurred in Anguilla. This

concept is known as "dual criminality". Drug trafficking offences are specifically excluded.

The following money laundering offences are created under the PCCA:

- assisting another to retain the benefit of criminal conduct (section 27);
- acquisition, possession or use of proceeds of criminal conduct (section 28);
- concealing or transferring the proceeds of criminal conduct (section 29); and
- tipping off (section 30).

The *mens rea* for the above offences will be as follows:

- the offence of assisting: "actual knowledge or suspicion" that the other person is or has been engaged in or benefited from criminal conduct;
- the offence of acquisition, possession or use: "actual knowledge" that the property represents another person's proceeds of criminal conduct; and
- the offence of concealing or transferring: "actual knowledge or having reasonable grounds to suspect" that the property represents another person's proceeds of criminal conduct.

Sections 27 and 28 of the PCCA provides for reporting suspicious transactions to the Reporting Authority. Both sections provide that, if a person makes a suspicious transaction disclosure to the Reporting Authority:

- that disclosure shall not be treated as a breach of any duty of confidentiality imposed by contract; and
- provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

Sections 3 to 8 of the PCCA provide for confiscation orders and sections 16 to 19 will provide for restraint orders and charging orders.

Section 31 enables the High Court to make an Order for the production of material relevant to an investigation into money laundering on the application of a police officer and section 32 enables a police officer to apply to the Court for a search warrant. Sections 33 and 34 of the PCCA provide for the registration and enforcement of external confiscation orders. An order designating countries or territories to which the sections apply will need to be made. We do not know how comprehensive it is intended that the designation order will be.

15.2.1.10 ***MLRAA***

The MLRAA establishes the Money Laundering Reporting Authority to which suspicious transaction reports under the DTOO and the PCCA will have to be made.

The members of the Reporting Authority are the Director of Financial Services, two senior police officers and the Deputy Comptroller of Customers all of whom are appointed by the Governor. Although we have been advised of the appointments to the Reporting Authority other than the Director, we have not been advised of the identity of the appointees.

The MLRAA also:

- disapplies the provisions of the Confidential Relationships Ordinance in relation to reports made to the Authority;
- provides gateways enabling the Reporting Authority to pass information to the police in Anguilla and, subject to certain restrictions, to criminal authorities in other countries or territories; and
- provides that any disclosure to the Reporting Authority will not be treated as a breach of any restriction upon the disclosure of information imposed by any enactment or rule of law and will not give rise to any civil proceedings.

15.2.2 **Regulations**

We have been advised that Anti-Money Laundering Regulations equivalent to the UK's Money Laundering Regulations 1993 have been drafted and that they will be brought into effect shortly. The PCCA provides that a breach of the regulations is an

offence.

15.2.3 **Guidance Notes**

The MLRAA provides for the Governor to issue Guidance Notes. Guidance Notes have been prepared and will shortly be issued.

The ECCB has issued Administrative Guidelines to domestic banks. These are enforced by review during the on-site visits. The ECCB regard the guidelines as minimum standards and expect that the Guidelines will be bolstered either by all crimes money laundering legislation, or regulations or guidance notes made thereunder, in the jurisdiction in which the bank is situate, or by the bank's own systems and procedures.

We note that Guidance Note 10 of the ECCB Guidance Notes begins:

"Where a financial institution chooses to make no report to the law enforcement authorities on the suspicious activity of one of its customers".

15.2.4 **Fiscal offences**

Fiscal offences will not be predicate offences under the PCCA and therefore co-operation cannot be provided. However even if other offences caught by the PCCA, such as fraud, have a fiscal element co-operation can still be given.

15.2.5 **Anti-money laundering - framework, systems and procedures**

15.2.5.1 ***Framework***

Until recently there were no anti-money laundering regulatory and law enforcement systems, procedures or framework in place in Anguilla. These have now been established. We further understand that no suspicious transactions reports have ever been made under the DTOO.

15.2.5.2 ***Domestic banks***

During the course of on-site visits the ECCB checks compliance with its transaction reporting requirements and its Administrative Guidelines (covering, for example, customer identification and the adequacy and frequency of anti-money laundering training).

15.2.5.3 ***Financial Investigations Unit/suspicious transaction reporting***

Now that MLRA and the PCCA have been enacted, there is an FIU in place. The MLRA provides that the reporting of suspicious transactions relating to drug trafficking will be made to the Reporting Authority, not to a police officer.

15.2.5.4 ***Attorney-General's Chambers***

The Chambers comprises one Senior Crown Counsel (Civil), one Senior Crown Counsel (Criminal), one Crown Counsel, a legislative draftsman together with the Attorney-General and support staff.

The Attorney-General's Chambers provides legal advice concerning the enforcement of the anti-money laundering legislation and will provide legal advice to the Reporting Authority when it is appointed.

Requests for co-operation are also dealt with by the Attorney-General.

15.2.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies, is primarily done through participation in the CFATF.

15.2.7 **Other measures to avoid money laundering**

There are no direct measures to detect or monitor the cross-border transportation of cash and bearer instruments. Where cash is discovered, however, and it is suspected that it is the proceeds of drug trafficking or any other offence under the PCCA, it is held and the person carrying it questioned as to its source.

There are no requirements to report transactions above a certain value.

There is no measurement system in place recording the international flow and reflows of cash, into or out of Anguilla, although this is likely to be very limited given the size of Anguilla's banking sector.

The legislation in Anguilla does not, and will not, distinguish between launderers who are public officials and others.

Anguilla has power under the Mutual Legal Assistance Treaty with the US to share assets seized with the US. There is no other jurisdiction with which Anguilla has this arrangement.

15.3 Issues and recommendations

15.3.1 Introduction

Shortly after the 1999 general election, there was a split in the coalition Government that resulted in the then Chief Minister losing his majority. The Opposition was unable to raise sufficient votes to pass a resolution of "no confidence" in the Chief Minister and boycotted the House of Assembly, which was no longer quorate. During this period, the House of Assembly was unable to meet and no new legislation was enacted.

We are advised that Bills for the CJICAA, the PCCA and the MLRAA had been drafted for a considerable time but, due to the legislative paralysis that ensued from the political deadlock described, these were not enacted until recently

Without legislation creating the various money laundering offences in respect of the proceeds of non-drug related crime, and with no regulations or guidance notes in place, Anguilla was, until recently non-compliant with many of the international standards concerning money laundering.

The current lack of regulations and Guidance Notes means that Anguilla does not yet comply with those FATF and CFATF Recommendations that apply to customer identification, record keeping and other anti-money laundering systems and procedures, the reporting of suspicious transactions to a reporting authority and the international standards reflected in the EC Money Laundering Directive of 1991. Regulations and guidance notes have been drafted (which we are advised mirror the UK model) and will shortly be issued and this is encouraging. However, given the recent production of the draft regulations and Guidance Notes we have been unable to review them in the timescales for this report.

Now the Bills have been enacted, we consider that Anguilla's primary legislation is modern and reasonably extensive. It contains most of the material and covers most of the issues that we would expect in a jurisdiction that is fully compliant with international standards. In particular, we are satisfied that the legislation taken as a whole means that Anguilla complies with most of the relevant parts of the Vienna Convention and the associated FATF and CFATF Recommendations. The only exceptions relate to the lack of offences of tipping off in drug trafficking matters and of possessing and using another's proceeds of drug trafficking.

However, there remain some deficiencies in the existing legislation that we recommend should be addressed as swiftly as possible. These are discussed below.

15.3.2 Legislation

15.3.2.1 *DTOO and CJICAO*

The offences of concealing, transferring or acquiring the proceeds of another's drug trafficking were created by the CJICAO (now replaced by the CJICAA). However, the offences of tipping off and possessing and using another's proceeds of drug trafficking are not provided for in either CJICAA or DTOO. Anguilla therefore does not fully comply with FATF Recommendation 17 and does not give full effect to article 3 of the Vienna Convention. The DTOO should be amended to include the above offences.

The *mens rea* for the offence of assisting another to retain the benefit of drug trafficking is "knowing or having actual suspicion" that the person assisted is carrying on or has carried on drug trafficking. We consider that the mens rea for the offences should be extended to cover a person who had "reasonable grounds to suspect" that the proceeds were derived from drug trafficking. This should also be included in the PCCA to bring Anguilla into line with what is envisaged by CFATF Recommendation 4.

The *mens rea* for the CJICAA offences of concealing or transferring or acquiring the proceeds of another's drug trafficking is "knowing or having reasonable grounds to suspect" that the property represents the proceeds of another's drug trafficking. This complies with international standards.

We recommend that:

- the DTOO should be amended to include the offences of tipping off and of possessing and using another's proceeds of drug trafficking; and
- the *mens rea* for the offence of assisting in the DTOO and PCCA should be extended to cover "reasonable grounds to suspect".

15.3.2.2 ***PCCA***

Sections 33 and 34 of the PCCA provide for registering and enforcing external confiscation orders. In the absence of a draft order designating countries to which the sections will apply we are unable to assess whether Anguilla is in full compliance with FATF Recommendation 38.

As indicated, the *mens rea* for the offence of assisting will be "actual knowledge" or "actual suspicion" and for the offence of acquisition will be "actual knowledge". We consider that the *mens rea* for each offence should extend to "having reasonable grounds to suspect", as envisaged by CFATF Recommendation 4.

We note that Anguilla's legislation does not distinguish between launderers who are public officials and others, as envisaged by CFATF Recommendation 5. Sentencing discretion should enable the judiciary to set higher penalties for public officials who commit money laundering offences. However, as there have been no money laundering prosecutions, it is unclear whether sentencing policy would reflect CFATF Recommendation 5.

There is no requirement to report transactions above a certain value. Whilst such a system is envisaged by FATF Recommendation 23 and CFATF Recommendation 14, the Recommendations do not make such a provision mandatory. We consider that a decision upon whether such a reporting regime should be implemented is for the jurisdiction itself to take rather than an international standard.

We recommend that the *mens rea* for the offences of assisting and acquisition is extended to having "reasonable grounds to suspect".

15.3.2.3 ***MLRAA***

The MLRAA overrides the Confidential Relationships Ordinance and provides gateways for the disclosure of confidential information to foreign law enforcement authorities. Anguilla will therefore be compliant with FATF Recommendation 32 on the enactment of MLRAA.

15.3.3 **Money laundering regulations**

The absence of money laundering regulations means that Anguilla does not yet comply with FATF Recommendations 8, 9, 10, 11, 12 18, 19, 20 and 21 and CFATF Recommendation 13.

We are advised that the proposed regulations are equivalent to the requirements of the UK Money Laundering Regulations, 1993, and therefore will comply with international standards as reflected in FATF Recommendations and in the EC Money Laundering Directive, 1990.

In respect of FATF Recommendation 19, we consider that testing compliance should form part of the on-site inspection process of the regulator.

We also consider that there should be a formal requirement for an audit of firms' anti- money laundering systems and that the audit of a regulated entity should include assessing compliance with the regulations.

Finally, we consider that the lack of a requirement to verify the identity of a client if the client was an existing client at the time that the Regulations were introduced is a weakness and not in accordance with good practice. It is possible that fictionally named accounts or other relationships could have been established prior to the date that the regulations came into effect and their exemption would permit their continued operation.

15.3.4 **Guidance Notes**

15.3.4.1 ***Introduction***

As already stated, guidance notes have been produced and will shortly be issued in Anguilla as the MLRAA and the PCCA

have been enacted.

15.3.4.2 ***ECCB Administrative Guidelines***

The ECCB Administrative Guidelines apply only to domestic banks.

Whilst we appreciate that the ECCB Administrative Guidelines are designed to establish only minimum standards, we do not consider them to be adequate. In the absence of a general Code of Practice, the ECCB should be encouraged to produce more definitive guidance to its licence holders concerning anti-money laundering systems and procedures. In particular, the Guidelines are too general and do not provide sufficient guidance to banks on areas such as introduced business.

We also recommend that Guidance Note 10, which appears to accept that there are circumstances when banks might not report a suspicious transaction, should be removed. We do not consider there to be any circumstances where non-reporting of a suspicious transaction is an option.

15.3.5 **Framework, systems, procedures and resources**

15.3.5.1 ***Attorney-General's Chambers***

The Attorney-General considers that he has sufficient funding and resources to enable him to undertake his function. Without a full review of the other commitments of Chambers, it is not possible to confirm this view.

15.3.6 **Monitoring developments in anti-money laundering techniques**

The current limited resources and lack of a formalised process for monitoring means that Anguilla may not always be up to date with developments. This problem should be alleviated by the creating of the Reporting Authority.

15.3.7 **Monitoring of compliance by regulated institutions**

We recommend that the scope of the regulatory review of financial institutions should be expanded to include an assessment of their compliance with the new requirements when they are in place. This will enable Anguilla to comply with FATF Recommendation 27.

15.3.8 **Business awareness**

We consider that the fact that there has never been a suspicious activity report made under the DTOO may be indicative of a lack of understanding of the legislation by the private sector. The introduction of the PCCA should, therefore, be accompanied by a formal training workshop for the private sector advising them of their responsibilities under the legislation and regulations. We welcome the fact that this has already commenced.

15.3.9 **Other regulations**

The lack of a regulatory system for securities and investment business may mean that persons who are not "fit and proper" can operate a financial institution. This is not in accordance with FATF Recommendation 29. Our recommendations in relation to this are contained in other sections of this Report.

15.3.10 **Cross-border flows of funds**

There are no direct measures to detect or monitor the cross-border transportation of cash and bearer instruments. Where cash is discovered, however, and it is suspected that it is the proceeds of drug trafficking or offences under the PCCA, it is held and the person carrying it questioned as to its source.

Whilst such a detection system is envisaged by FATF Recommendation 22, the Recommendation does not make the provision mandatory. We consider that the implementation of such a system is an option, rather than an international standard.

Anguilla should consider co-operating with the ECCB to impose a requirement upon licensed banks and other relevant institutions to report cash flows to and from abroad, in accordance with FATF Recommendation 30 and CFATF Recommendation 15. Such reporting should be to the ECCB or the FSD.

We welcome your comments on this site.

Prepared 27 October 2000

Appendix 1

PREAMBLE: REVIEW OF FINANCIAL REGULATION IN THE CARIBBEAN OVERSEAS TERRITORIES AND BERMUDA

The Overseas Territories' White Paper proposes establishing a renewed contract between the UK and the Overseas Territories (OTs). A modern and effective partnership should be built upon the foundations of responsibilities on both sides, coupled with the UK assisting the OTs where necessary, and the OTs exercising control over their own lives in a responsible way.

The UK is pledged to look after the OTs' interests internationally. This goes hand in hand with the OTs meeting accepted international standards, and playing a responsible role in the international community. In the area of offshore financial services, some of the OTs are significant players in their own right. The business conducted in offshore centres is often linked intrinsically with activities regulated in other countries, including the UK and our key international partners. The quality of regulation in the OTs has an indirect or direct effect on people, firms, and markets in other countries, as well as the international financial system.

The Terms of Reference provide for an indepth independent review by experts to assess progress made in the regulation of the offshore sector, and to make further recommendations on how to deal with outstanding issues. HMG circulated Guidance Notes to Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands which indicate accepted international standards and good practice in financial regulation. Following consultation with these OTS, the Guidance Notes and Terms of Reference for the review of financial regulation in the OTs have been revised.

2 September 1999

TERMS OF REFERENCE FOR THE REVIEW OF FINANCIAL REGULATION IN ANGUILLA, BERMUDA, BRITISH VIRGIN ISLANDS, CAYMAN ISLANDS, MONTSERRAT AND TURKS AND CAICOS ISLANDS

PURPOSE OF THE REVIEW

-To assess Overseas Territories' (OTs) performance against international standards and good practice as set out broadly in the Guidance Notes[3].

-To make recommendations for improvement where the OTs fall below these standards.

REGULATION OF FINANCIAL ACTIVITY

The review should list separately the type and composition of offshore financial services business in each OT ie. Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands. It should ascertain what legislation, regulations, rules, guidance, systems, and procedures (statutory or otherwise) govern the regulation and supervision of the:

-banking sector;

-insurance sector;

-securities sector, including mutual funds and stock exchanges.

This assessment should cover the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulation and laws.

The review should evaluate to what extent arrangements in the OTs meet standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to relevant standards provided by these bodies are broadly set out in the

Guidance Note covering this section. The review should consider the adequacy of the system of supervision relative to the objectives of an OT's financial services regulation. It should comment on the existence and adequacy of depositor and investment protection schemes. The review should determine whether further action is required by any territory in order to meet the standards broadly set out in the relevant Guidance Note, and prioritise recommendations.

REGULATION OF COMPANIES, PARTNERSHIPS, TRUSTS

The review should supply a breakdown of the type and composition of the company, partnership, and trust sectors in each OT, including company and trust service providers and formation agents, the involvement of professionals (accountants and lawyers), and the scale of activity. It should determine and assess the legislation, framework, systems, rules, regulations, guidance and procedures in place which provide for the regulation of activity in these sectors. The review should establish whether these arrangements conform to good practice and standards outlined in the relevant Guidance Note, which in turn refers to the principles set out in: the Basel Committee on Banking Supervision; International organisation of Securities Commissions (IOSCO); the Financial Action Task Force 40 Recommendations; Caribbean Financial Action Task Force Aruba Recommendations, the International Accounting Standards Committee, the G22 report on Transparency and Accountability (October 1998), IMF Guide to Progress in Strengthening the Global Financial Architecture (April 1999) and the OECD Principles of Corporate Governance.

The review should evaluate the appropriateness of the regulatory measures in place, including the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulations, and laws.

Furthermore, it should ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts. The review should detail the type of information available on the activities of company, partnership and trust. It should determine whether the mechanisms in place are sufficient. The review should also consider whether further action is required by any territory to meet the standards broadly set out in the Guidance Note, and prioritise recommendations.

INDEPENDENT REGULATORY AUTHORITIES

The review should evaluate to what extent regulatory authorities comply with accepted international standards advocated, principally, by Basel, IOSCO, OGBS and IAIS.

In particular, the review should evaluate whether regulatory authorities are accountable, independent and free from business and political influence, and properly staffed and budgeted for, with an independent source of income. It should determine whether the authority is detached from the marketing of financial services and where this is not so any impact this may have on the ability of the regulatory authority to regulate the sector objectively. The review should assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance, and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; cooperate with requests for assistance from foreign authorities and; enforce rules, regulations, laws by taking enforcement action, and the extent to which they can liaise with law enforcement authorities in the sharing of information. The review should consider which activities fall under the responsibility of the regulatory authority, and whether the regulatory net covers all financial activities. it should comment on the resources available to the authority, both for the purpose of recruitment, training and retention of staff and its infrastructure, such as the use of technology.

The review should consider what legal advice is available to the authority and its effectiveness in helping the OT government to regulate the sectors.

INTERNATIONAL COOPERATION

The review should evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of OT law enforcement and regulatory authorities to cooperate with requests for assistance from foreign authorities. The necessary requirements are broadly set out in the relevant Guidance Note. The review should ascertain what legal advice is available to OT regulatory and law enforcement authorities and its effectiveness in helping the OT government to co-operate in these areas. The review should determine whether further action is required by any territory in any of these areas, and the relative priority of such action.

<u>Cooperation between regulatory authorities</u>

The review should consider whether there are effective 'Gateways' provisions in place; OTs' powers to obtain information,

including by compulsion; ability of foreign authorities to take voluntary testimony from OT residents; an OT's ability to safeguard the confidentiality of information provided by foreign counterparts; provisions governing conditions under which information may be passed to overseas jurisdictions; whether effective Memoranda of Understanding exist, where required to underpin cooperation.

Cooperation between law enforcement authorities

The review should assess the extent of cooperation to which OT law enforcement authorities can obtain evidence on behalf of their foreign counterparts, and exercising other available mutual legal assistance powers, stating the mechanisms and OT authorities involved; an OT's ability to assist foreign authorities in tracing, freezing and confiscating proceeds in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (November 1990), even if the underlying conduct takes place outside the OT; the effectiveness of Mutual Legal Assistance Treaties with the USA where applicable, and the provision of basic statistics on the volume of requests for assistance made and received; powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted; ability to safeguard the confidentiality of information provided to OT authorities; whether effective Memoranda of Understanding exist, where required to underpin co-operation.

Cooperation between regulatory and law enforcement authorities

The review should evaluate whether there is effective cooperation between law enforcement authorities and financial regulators, both domestically and abroad, as specified by the G7 key 10 principles. It should also consider the ability of OT regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

MEASURES TO COMBAT MONEY LAUNDERING

The review should establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the OT to combat money laundering, and types of offences caught by the legislation. It should determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.

The review should evaluate the effectiveness and adequacy of these arrangements, in terms of how they meet the standards broadly set out in the relevant Guidance Note, which in turn refers to: 1988 UN Drugs Convention; FATF 40 Recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990), and CFATF Aruba Recommendations. Furthermore, it should consider to what extent the OTs apply standards set out by the EC Money Laundering Directive (June 1991), the standards on which UK anti-money laundering legislation is based.

Specific consideration should be given to those offences considered predicate for the purposes of money laundering legislation; whether OTs have regulatory legislation in addition to the principle money laundering offences, and if not, whether guidelines and/or Codes of Practice exist (statutory or otherwise); their systems for reporting suspicious transactions and identifying customers; the institutions obliged to report; how reports are dealt with; and within what timeframe. The review should consider how this information is disseminated and shared with foreign counterparts. It should evaluate ability of Financial Intelligence Units (FIUs), or equivalents, to deal with suspicious transactions ie. whether staff have been properly trained and capable of conducting financial investigations and analysis; the resources at their disposal; feedback to the financial institutions.

The review should determine to what extent the AttorneyGeneral's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws. This not only relates to the prosecution of cases but the provision of assistance to foreign jurisdictions in pursuance of money laundering legislation.

FORMAT OF REPORT AND TIMESCALE

FCO, HM Treasury and OT representatives will wish to agree with KPMG the precise format of the report during Phase 1 of the workplan.

KPMG should provide written monthly reports to the Steering Committee (in electronic form) and attend Committee meetings at least during Phases 1, 2 and 5 (dates to be agreed).

10 December 1999

THE SUPERVISION OF THE BANKING, INSURANCE AND SECURITIES SECTORS

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories states that the Overseas Territories (OTs) should seek to implement "*legislation for the effective regulation of the offshore sector which fully meets accepted international standards*". In many cases the OTs have already implemented some of the standards, but no attempt is made here to analyse individual territories' performance to date. Such an analysis is the objective of the independent review foreseen in the White Paper, and to attempt it in the context of this paper would result in a superficial and incomplete impression of where matters stand. Instead, the purpose of this paper is to provide an overview of the framework within which international standards relating to the regulation of banking, insurance and securities business are established, and to offer an outline of the broad standards that have evolved. The paper is not intended to act as a substitute for the study of the detailed documents published by the respective standardsetting organisations, primarily the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to these documents can be found in the following text and, specifically, in publications available on the respective websites. The following are also key documents:

Core Principles for Effective Banking Supervision	Basel Committee	Sept 1997
The Supervision of CrossBorder Banking	Basel Committee	Oct 1996
Insurance Principles, Standards and Guidance Papers	IAIS	Oct 1998
Objectives and Principles of Securities Regulation	IOSCO	Sept 1998

THE OBJECTIVES OF SUPERVISION

2. The objectives of financial services supervision fall into four broad categories:

- to secure the appropriate degree of protection for consumers of financial services;
- to maintain confidence in the financial system;
- to promote public understanding of the financial system; and
- to reduce the scope for financial crime.

3. The protection of consumers' interests does not assume an absolute objective to prevent financial consumers from losing money, but rather to create an environment where financial risk is better understood, and where there is less chance of consumers taking unnecessary and excessive risks. As stated in a recent Occasional Paper published by the UK's Financial Services Authority, this process requires "*having regard to the differing degrees of risks involved in different kinds of investment, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions*"[4]. Delivery of the appropriate environment involves both proper transparency and disclosure by financial institutions, and the effective enforcement of laws, regulations and rules by the regulators.

4. Preservation of confidence in the financial system has at its core the need to mitigate the risk of systemic failure, or of the system falling into disrepute. This will not necessarily be focused on the narrow issue of whether individual depositors or investors are threatened with the loss of money, but on whether the system as a whole might be under threat from the failure of one or more institution. There are circumstances in which individual financial institutions can and should be allowed to fail without fear of a threat to the system, even though there might be losses for the customers of those institutions.

5. The rising tide of financial crime has increasingly posed threats to the integrity of financial systems. This impacts upon both the financial stability of institutions and upon the reputation of individual jurisdictions. Although financial services supervisors are not expected to police the wider criminal laws, it is clearly important for the supervisors to play their part in reducing the exposure of the financial services sector to criminal abuse, and in tackling financial crime and regulatory abuse. This requires OT regulatory authorities to have appropriate investigative powers and specialist enforcement branches, and to cooperate fully with the authorities in other jurisdictions. The responsibility for investigating individual cases of money laundering should, however, fall to OT law enforcement authorities.

THE SUPERVISORY FRAMEWORK

6. Perhaps the single most important aspect that underpins the integrity of the financial services sector is a longterm political commitment to effective regulation and supervision. Without such commitment the regulators will always be starved of the tools needed to achieve an effective result.

7. Fundamental to this process is a willingness to enact comprehensive regulatory legislation, to develop the associated regulations, rules and guidance, and to keep this structure under review to ensure that it stays abreast of trends both in the financial services industry itself, and in the development of regulatory practices. While the individual techniques of supervision and enforcement may vary in order to address the respective distinctive features of the offshore and domestic sectors, the fundamental standards applied to the offshore sector should not differ from those expected for the domestic market. With regard to the offshore sector, it is essential that due regard is paid to the regulatory implications in tandem with any moves taken to facilitate the development of business. Moreover, there should be no attempt to encourage "regulatory arbitrage" by seeking to offer a lighter regulatory regime than exists in competitor jurisdictions.

8. A central part of the legal framework must be provision for an effective, operationally independent and accountable regulatory authority with the appropriate powers to fulfil the objectives identified in section 2. However, legal form alone is not sufficient to provide the basis for an effective regulatory system. There needs also to be an allocation of resources in line with the structure, scale and complexity of the financial services sector. This involves an acceptance of the need to invest in the staff and infrastructure of the regulatory authority in order to ensure that it has appropriate skills and tools to meet the tasks expected of it. It has also to be recognised that there can be no formalistic approach to the funding of the regulatory regime, based, for example, on the direct benefit derived by government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision. By entering the offshore market a jurisdiction has to accept that not only does it have a duty to preserve the reputation and standing of its own financial system, but that it also assumes a wider responsibility to the international community to help ensure the integrity of the global market.

THE DEVELOPMENT OF INTERNATIONAL STANDARDS

9. The increasing internationalisation of financial services in the past decade has led to a drive to establish some common minimum standards of supervision. The application of these standards is seen as particularly important in financial centres with a high proportion of international business, since the failure of supervision there may have far wider implications than simply for the local market.

10. Standards for the supervision of the banking sector have been developed over many years under the auspices of the Basel Committee on Banking Supervision which promulgated the first Basel Concordat in 1975. In recent years there has been a rapid increase in publications emanating from Basel, many of which are intended to represent accepted international standards. Although the Basel Committee is an organisation whose membership comprises the G10 countries, it has a number of "regional" affiliates, not least of all the Offshore Group of Banking Supervisors, which have been closely involved in the development of the standards in recent years. The list of publications produced by the Basel Committee is available on the website of the Bank for International Settlements (www.bis.org). In the context of this paper the most significant of the documents are *The Core Principles for Effective Banking Supervision* (published in September 1997), which delivers 25 basic principles, and *The Supervision of CrossBorder Banking* (published in October 1996), which contains 29 recommendations.

11. In the insurance sector standards are increasingly being established by the International Association of Insurance Supervisors (IAIS). The IAIS was established in 1992 and has membership of about 100 jurisdictions, including several offshore centres. Until 1996 it had no standardsetting powers, but since that time has produced a number of standards and guidance papers. These are consolidated within the *Insurance Principles, Standards and Guidance Papers* published in October 1998. The IAIS standards focus on particular supervisory issues, describing the best or most prudent practices, while the guidance papers are designed to assist regulators to raise the effectiveness of supervision. The IAIS is in the process of developing a website which should be available shortly.

12. The primary international standards body in the securities sector is the International Organisation of Securities Commissions (IOSCO). Like the Basel Committee, IOSCO has been working over many years and published its first *Resolution on the Regulation of Securities Markets* in 1983. Unlike Basel, its membership is big (over 90 countries) and includes a large number of emerging markets and offshore centres. IOSCO's bylaws include clear objectives, with which all members are expected to comply. They include the requirements for members to cooperate, to promote high standards of regulation, to apply the standards rigorously, to establish effective surveillance and enforcement, to maintain just, efficient and sound markets, and to exchange information. In September 1998 IOSCO published its *Objectives and Principles of Securities Regulation* which sets out the 30 Core Principles of securities regulation. In addition, IOSCO has over the years produced a substantial range of other documents which represent commitments by the membership, guidance or standards, and which are available on its website (www.iosco.org).

13. Although membership of these standardsetting organisations, or their affiliates, has been open to offshore centres,

acceptance of, and compliance with the principles that the organisations espouse are essential preconditions for membership.

OVERVIEW OF THE COMMON PRINCIPLES

14. It has to be reiterated that the documents referred to in this paper are essential reading, and it is not the intention of this paper to provide a substitute summary. However, in considering the structure of the overall regulatory regimes required in the OTs it is important to identify the common themes that underpin the regulation of all three sectors. This section seeks to highlight these themes. However, it is important to appreciate that, while there are common characteristics of the regulation of the different sectors of the financial services industry, different skills and processes will be required to effect proper regulation of each sector. The reference documents address these differences.

A. General Principles

a) Regulation should be vested in a properly constituted authority which should be operationally independent from political and commercial interference in the exercise of its functions. However, it should also be openly accountable in the exercise of its powers (see also the separate paper on *Independent Regulatory Authorities*).

b) The regulatory authority should have a clear, adequate, achievable and consistent framework of responsibilities, objectives and powers set by legislation, and it should adopt processes which are fair, consistent, transparent to the public, and demonstrably geared towards achieving the objectives.

c) The regulatory authority should have adequate funding to enable it to acquire the resources (staffing, technology, infrastructure etc) to fulfil its responsibilities. The funding should be available in such form that it does not compromise the authority's independence from both political and commercial pressures.

d) The regulatory authority should have due regard to the need to compete with the commercial sector for skilled staff, and should structure its terms and conditions of employment accordingly. It should also ensure that its staff receives ongoing training.

e) The system of supervision should involve both offsite surveillance and onsite examination. This requires the regulatory authority to have the powers not only to set the scope, content and frequency of routine reporting by regulated institutions, but also to have access, whenever it considers it appropriate, to the books, records, accounts and other documents maintained by the institutions. There should be no secrecy barriers to limit the regulators' access to information.

f) The regulatory laws should establish proper licensing standards and criteria, and the regulatory authority should adopt effective procedures to ensure that applications are reviewed in a thorough and consistent manner. As a minimum this should require the implementation of comprehensive due diligence procedures in relation to controllers, directors and managers of prospective licensees, and a detailed analysis of an applicant's business plan, internal controls, projected financial condition and likely ability to comply with established prudential standards.

g) The regulatory laws should provide for notification of any intended change in ownership or control of a regulated institution, and for such changes to be subject to prior approval by the regulatory authority.

h) The regulatory authority should have the powers to implement and enforce prudential standards both generally across the entire sector, and specifically in relation to individual institutions. For example, this requires that the authority adopt and enforce suitable standards for capital adequacy, solvency, liquidity, risk concentration, asset valuation etc, taking account of accepted international standards and guidelines.

i) The regulatory authority should require institutions to maintain minimum standards of corporate governance, internal controls and operational conduct with the aim of protecting the interests of clients, ensuring proper management of risk, and accepting primary responsibility for these matters. Careful attention should be paid, for example, to the role and responsibilities of the board of directors, the arrangements for delegating authority and responsibility, the separation of duties, the safeguarding of assets and the procedures for internal audit.

j) Regulated institutions should be required to maintain proper books, records and accounts.

k) There should be procedures for dealing with the failure of a market intermediary in order to minimise damage and loss to financial consumers and to contain systemic risk.

1) The regulatory authority should be vested with comprehensive and credible inspection, investigation,

surveillance, and enforcement powers, including

- powers to take action to ensure compliance with regulatory requirements;
- powers to impose administrative sanctions for noncompliance;
- powers to initiate or refer matters for criminal prosecution; and
- powers to suspend or revoke authorisation to conduct business.

m) Regulated institutions should be subject to independent external audit in accordance with international accounting standards, and should be required to disclose to the public information regarding their activities and financial position that is comprehensive and not misleading. This information should be sufficient for financial consumers and market participants to assess the risk inherent in individual institutions.

n) The establishment of trading systems, including securities exchanges, should be subject to regulatory authorisation and oversight. Trading should be supervised in a way which ensures that the integrity of the market is maintained. There should be fair and equitable rules which strike an appropriate balance between the demands of different market participants.

o) Market regulation should promote the transparency of trading, be designed to detect and deter manipulation and other unfair trading practices, and aim to ensure the proper management of large exposures, default risk, and market disruption.

p) Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and be designed to ensure that they are fair, effective and efficient, and reduce systemic risk.

q) The regulatory system should set appropriate standards for the eligibility and regulation of collective investment schemes; provide for rules governing their legal form and structure, and for the segregation and protection of client assets; require disclosure necessary for evaluating the suitability of a scheme for particular investors; and ensure that there is a proper and transparent basis for the pricing and redemption of units.

r) The regulatory authority should have the powers and procedures to ensure that regulated institutions take action to protect themselves against criminal misuse, and that they maintain appropriate systems to comply with anti-money laundering regulations.

B. Cross-Border Issues

a) The regulatory laws and supervisory policy and procedures of a jurisdiction should seek to ensure that no institution operating across national boundaries escapes supervision, and that the supervision should be effective. In this context attention should be paid not only to corporate structures that might frustrate effective consolidated supervision (e.g. parallel-owned entities), but also to arrangements where the physical location of the licensee's mind and management differs from that of the regulator (e.g. shell branches).

b) The creation of a crossborder establishment in the regulated sector should be subject to prior consultation and agreement between the home and host regulators. This is essential not only to ensure proper assessment of the application, but also to enable both parties to agree the necessary procedures for ongoing supervision of the institution.

c) The regulatory authority should be empowered to collect both public and nonpublic regulatory information, and to share this in accordance with international principles with domestic authorities and foreign counterparts. Co-operation in the exchange of such information involves exchanges of a routine nature and the provision of assistance in an enforcement investigation, as well as in the event of the emergence of serious problems (see also the separate paper on *International Cooperation*).

d) The regulatory authority should have the powers to assist an overseas regulator in the fulfilment of its functions. This may involve assistance in obtaining information or records, but will also extend to the use of investigative or compulsory powers on behalf of the overseas regulators. Secrecy or confidentiality provisions in the law of a jurisdiction should not be used as a means of impeding such assistance.

e) There should be no barriers to prevent a home country regulator from undertaking such procedures, and having access to such information in the host country as it considers necessary to undertake the effective consolidated supervision of an international financial services group.

THE FUTURE DEVELOPMENT OF STANDARDS

15. The rate of development of internationally recognised and accepted regulatory standards has accelerated in recent years, and further announcements should now be expected on a regular basis. Therefore, it is important to appreciate that compliance with international standards is not a static or "oneoff" process, but will require regular updating of laws, policies and procedures. With this in mind, regulatory authorities in the OTs should continue to monitor international developments, particularly where they participate in or are affected by the work of one or more of the key international standardsetters mentioned above. They should, in particular, be prepared to recommend changes in legislation where appropriate, and to implement new procedures to ensure that compliance is kept up to date. This applies in all three of the main sectors referred to in this paper.

IMPLEMENTATION

16. Standardsetting is not, by itself, enough. It needs to be accompanied by active monitoring of compliance with these standards, and the commissioning of the independent review of the OTs must be seen in the wider context. The G7 report on *International Financial Architecture*, agreed at Cologne, said:

"*With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation*."

17. The standardsetting regulatory bodies the Basel Committee, IOSCO and IAIS are now working increasingly closely with the IMF and the World Bank. In the field of banking supervision, for example, the Basel Committee, the IMF and the World Bank, working with selected supervisors around the world, have developed a *Core Principles Methodology* text which provides detailed guidance to the IMF and World Bank for their assessments of compliance. It is expected that such assessments will be made for an increasing number of countries and territories around the world; and that the results of such assessments will be used by regulators (see for instance the Basel Committee's consultative paper on a *New Capital Adequacy Framework*) and by the Washington institutions (as a precondition in the IMF's new Contingency Credit Line).

18. An IOSCO Implementation Committee, in which the IMF, World Bank and the regional development banks participate, has been set up to oversee the implementation by IOSCO members of the 30 Core Principles. Cooperation between IOSCO and the international financial institutions is at the heart of this process.

COMPANIES AND TRUSTS

1. There are legitimate reasons for using company and trust vehicles. However, the White Paper "Partnership for Prosperity" (Appendix 2, paragraph 4) states "We shall also press Overseas Territory governments to introduce legislation to improve regulation of company formation and management because, for example, in the absence of proper regulation, complex company structures can be used to disguise the proceeds of crime and other regulatory abuse as well as providing limited liability." The White Paper continues "Company formation agents and company managers need to be required by law to hold key information about the companies for which they have responsibility and to disclose that information to a regulator on request. This will ensure a properly documented paper trail for criminal and regulatory investigations."

2. This paper considers the issues of company and trust regulation relevant to the regulation of the financial system. The paper does not set out a blue-print for Company and Trust Law and regulation as a whole - that would be outside the scope of the Review, and constitute a major undertaking in its own right. The two sectors - companies and trusts - fulfil very different purposes, and their regulatory regimes have evolved in different ways, to meet different objectives. Nevertheless, in respect of their potential as vehicles for abuse, the issues raised by the trust and company sector are similar, and for this reason, this paper treats them in parallel. But the Review may wish to consider them as distinct sectors.

4. The opportunities for companies and trusts to be used for criminal purposes cannot be removed. Effective regulation can help reduce the scope for criminal abuse of such vehicles. There is no single international group of company and trust regulators. Nevertheless, the regulatory principles established by other international bodies in relation to other financial sectors apply equally well to the company and trust sectors:

The principle that financial institutions should know their customers (established by - among others - the Basle and IOSCO standards) applies with particular relevance to situations in which the ownership of assets may be obscured through company and trust vehicles;

FATF Recommendation 11 requires financial institutions "to take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether

these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located)". The interpretative note to this recommendation states "a bank or other financial institution should know the identity of its customers, even if these are represented by lawyers....accordingly, recommendation 11 also applies to the situation where an attorney is acting as an intermediary for financial services". This accepted international standard implies that financial institutions should be able to delve beneath a corporate or trust structure, to establish the true beneficial owner and other relevant parties, and not simply the name of a lawyer acting as an intermediary.

The FATF's Recommendation 25 states "Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities";

International standards on accounting, disclosure and auditing practice; covering timeliness in the provision of financial information, completeness, consistency, risk management, audit and control. The relevant standards include those set by the International Accounting Standards Committee; the G22 report on transparency and accountability, October 1998; and the IMF *Guide to Progress in Strengthening the Global Financial Architecture*, April 1999). These standards are particularly relevant when there are obligations to third parties arising;

Standards of corporate governance, reflected in the *OECD Principles of Corporate Governance*, which OECD members, in co-operation with the World Bank and IMF, are committed to promoting amongst non-member countries;

The Home Office report on "*Financial Regulation in the Crown Dependencies*" (The "Edwards Report") makes specific recommendations, based on the internationally accepted principles outlined above, for the company and trust sectors of the Isle of Man, Guernsey and Jersey.

5. Satisfying these principles implies the following;

(i) Beneficial ownership.

It should be possible for law enforcement and regulatory authorities to ascertain, quickly and efficiently, and in advance of formal proceedings, the true owner of assets held by a company or trust, and the source and nature of financial transactions. It is essential to be able to trace the ultimate individual beneficial ownership of companies and to get beyond elaborate structures in which companies are owned by layers of other companies and/or trusts, which obscures the ultimate owner.

In the company sector, this would involve the OT authorities having the means to identify company directors and the beneficial ownership of shares, eg where nominees exist. Effective custody arrangements would need to be in place in relation to bearer shares. In the trust sector, OT authorities should have the means to be able to identify the settlor, the beneficiaries, the trustees, the protector, and the custodian, where applicable, and should be able to obtain a copy of the trust instrument. This would help identify 'sham' trusts, for example. OT authorities should have the means to obtain up-to-date information, and to obtain such information in relation to companies and trusts which might be established in other jurisdictions, yet which might be managed or move to the OT concerned.

(ii) Anti-money laundering systems.

Intermediaries providing corporate or trust services should have in place effective anti-money laundering measures, including "know your customer", record keeping, and staff training requirements. Suspicious transactions involving companies and trusts should be disclosed to a Financial Intelligence Units. (More details on anti-money laundering standards are set out in the 'Money Laundering Guidance Note').

(iii) Transparency of financial arrangements.

Basic financial information relevant to the activities of companies and trusts should be available, quickly and efficiently, and in advance of formal proceedings, to law enforcement and regulatory authorities. Ideally, such information in the company sector should also be available to customers, shareholders, suppliers and lenders, where appropriate. In the trust sector, trustees should ideally be held accountable to the beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector where applicable.

The Review will wish to consider in which circumstances it would be appropriate to require accounts to be produced, in which circumstances such accounts should be made public, in which circumstances abbreviated accounts might be acceptable, and in which circumstances the requirement to produce accounts should not be applied. The latter might apply where single asset holding vehicles exist with no third party involvement.

(iv) Obligations on directors, trustees, and company and trust service providers.

Measures should be in place to ensure that directors and trustees fulfil their "due diligence" obligations effectively, and to prevent nominees from assigning their responsibilities to others through general powers of attorney, and being used as a cover for criminal activities and regulatory breaches. More generally, those who provide corporate and trust services should be licensed, and subject to effective regulation. The "four eyes" principle should apply. The codes which apply to company and trust managers should be complementary, for example to avoid a situation in which inter-linking ownership of company and trust vehicles can be used to obscure beneficial ownership. OT authorities should be able to identify the true directors and owners of a company, and the settlors, beneficiaries, trustees, protectors, and custodians of a trust. The rules, regulations, and laws relating to insolvency and bankruptcy should also be examined by the Review, to ensure that these may not be abused, eg for the purpose of defrauding shareholders.

(v) Investigative and enforcement powers.

OT authorities should be able to apply full investigative powers to those (eg directors, beneficial owners, settlors, beneficiaries, trustees, nominees) who are suspected of criminal activity. This extends to applying the compulsory powers referred to in the paper on 'International Co-operation'. OT authorities should be able to identify the links which may exist between companies and trusts. OT authorities should launch appropriate investigations in the face of bankruptcy and insolvency. More generally, the regulation of company and trust service providers and formation agents needs to be accompanied by effective and independent enforcement powers, including the power to monitor and supervise licensed formation agents and service providers, to inspect their activities, to investigate potential breaches of rules, regulations, and laws, and to take appropriate enforcement action. The latter would include the ability and willingness to take disciplinary action (eg remove licences) as well as to pursue civil and criminal sanctions.

(vi) Removal of impediments to asset tracing and seizure.

Trust and company arrangements should not be able to be used to frustrate the due process of law in attempts to trace and seize assets.

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories explains that one of the "key components of the regulatory package we wish to see in place by the end of 1999" is "the establishment of independent regulatory authorities meeting accepted international standards". The Financial regulation checklist appended to the White Paper provides further detail on what this amounts to.

2. Four publicly available papers provide more specific details on what the international community expects from a regulatory authority. These documents are (i) "Objectives and Principles of Securities Regulation" by the International Organisation of Securities Commissions; (ii) "Core Principles for Effective Banking Supervision" by the Basle Committee on Banking Supervision; (ii) "The Supervision of Cross-Border Banking" by the Basle Committee on Banking Supervision and the Offshore Group of Banking Supervisors; (iv) "Insurance Principles, Standards and Guidance Papers" by the International Association of Insurance Supervisors.

KEY FEATURES

(i) Independence

Independence is required in order to generate confidence, in particular that all market participants will be treated objectively and fairly, and that rules and regulations will be applied uniformly in such a way as to protect investors and promote orderly market activity. These objectives will not be satisfied unless the regulatory authority is clearly seen to act independently, and to have sole responsibility for regulating market activity.

4. The concept of independence does not imply that regulatory authorities are unaccountable. Instead, it implies that their day to day operations should be free from political or commercial control and influence. These executive operations include all the regulator's key functions, such as (a) deciding to issue, suspend, and withdraw licences; (b) supervising and inspecting the activities of licence holders, including issuing rules and regulations; (c) undertaking investigations; (d) taking enforcement action, and; (e) co-operating with overseas authorities. The regulatory authority should have the necessary powers and ability to regulate all licensed activity.

5. Proper independence requires the regulatory authority to exist as a stand-alone body, rather than as eg a separate unit

within the Finance Ministry. Independent regulatory authorities are typically established by statute, which sets out the authority's powers and responsibilities. Those working in the authority, including senior management, should not have any external commercial or political interests or responsibilities (including unpaid directorships). The regulatory authority should not be required to secure OT government approval before exercising its executive powers.

6. Independence extends to the authority's functions. The regulatory authority should not be charged with any political or commercial responsibilities. In particular, the authority should not seek to market its jurisdiction as a place for business to locate. All such hard selling and marketing should be undertaken by a separate body which is not connected in any way with the regulatory authority (again, members of staff should not work in both bodies). Such separate promotional bodies should not be funded by the regulatory authority. Essentially, the job of selling the merits of doing business in a particular OT should be left either to OT governments or to the private sector. It would, however, be open to the regulatory authority to provide information about the regulatory regime in the jurisdiction to potential inward investors.

7. Independence extends to the way in which the authority is resourced. Regulatory authorities should be self-supporting and have their own source of income, independent from Government control. This is often raised through licence fees or another form of industry levy. Where these fees currently account for a large proportion of OT government income, the authority would return any excess income to the government.

8. Independence does not imply isolation. The regulatory authority should consult both the industry and the OT government before seeking to make any changes to broad regulatory policy, and before seeking to make changes which have national policy implications, or which have significant implications for the industry. These implications can properly include considerations of internal and external competitiveness, within the parameters of relevant international standards.

(ii) Accountability

9. Independent regulatory authorities are subject to a number of checks and balances, which in turn ensure that they are held accountable for their actions. In particular;

(a) Statutory objectives. The objectives of the authority should be laid down by statute drawn up by the OT Government. These objectives should reflect the need to satisfy internationally accepted standards of regulation.

(b) Appointments. The authority should operate under a properly constituted board or Commission, which holds a mix of relevant expertise. All board/Commission members should be appointed on the basis of that expertise by the OT Government, or by the Governor in consultation with the OT Government (eg where the Governor retains responsibility for the offshore sector). All key policy decisions should be approved by the board.

(c) Legislation. Legislation covering financial regulation as a whole will often need to be amended or introduced in order to make any significant changes to the regulatory regime. Regulatory authorities do not normally have the power to make such legislation, and will need the support of those who do if significant changes are to be made to the regulatory regime.

(d) Annual report. The authority should produce an annual report available to the public explaining its operations over the past year, how its objectives have been tackled, how resources have been allocated, and how it intends to tackle its objectives in future. This would include publishing a set of audited accounts and possibly a Statement of Principles. The annual report should identify where problems have been encountered in meeting international standards, and how the authority intends to deal with these problems. OT Governments should question the authority in relation to its annual report.

(iii) Functions and powers

10. The documents mentioned in paragraph 2 provide full detail on the types of function expected of a regulatory authority. For the purposes of this paper, it is worth noting simply that the regulatory authority should have sole responsibility and powers in the following areas. These functions relate to the regulation of activity;

(a) Licensing. The regulatory authority should have sole responsibility for issuing, suspending, and withdrawing licences. This extends to having the powers and ability to investigate whether persons are 'fit and proper' to work for a licensed firm.

(b) Determining how licensed firms and persons should conduct business. The regulatory authority should have sole responsibility for setting conduct of business rules and regulations, and providing guidance for market practitioners. Where legislation is required, the authority should be able to make proposals to OT governments.

(c) Supervising and monitoring licensed activity. The regulatory authority should monitor all licensed activity. This would involve establishing regular (eg quarterly) reporting systems plus a programme of regular and 'surprise' inspections.

The regulatory authority should not require the prior approval of any external body before conducting such inspections.

(d) Investigating. The regulatory authority should conduct in-depth investigations into suspected breaches of rules, regulations, and laws. The regulatory authority should have the power to compel the production of information from both licensed and unlicensed firms and persons, in the ways outlined in the paper on 'International Co-operation'. In particular, the regulatory authority should not pursue criminal investigations outside the regulatory function - the law enforcement authorities should be responsible for leading those investigations.

(e) Taking enforcement action. The regulatory authority should have the powers to take appropriate enforcement action in response to breaches of rules, regulations, and laws. This would include the ability to suspend and withdraw licences, the ability to issue directions, and the ability to levy fines. Where criminal activity is encountered, lead responsibility for taking enforcement action would normally fall to the law enforcement authorities in conjunction with the prosecuting authorities.

(f) Co-operating with other authorities. Where serious breaches are encountered, the regulatory authority would be expected to co-operate fully with other authorities within the OT, such as prosecuting and law enforcement authorities. This would essentially involve the regulatory authority handing over information it had obtained before it became clear that criminal activity was at hand, rather than the regulatory authority undertaking any criminal investigations. OT authorities should also co-operate fully with authorities based overseas, in the ways outlined in the paper on 'International Co-operation'.

(iv) Resources

11. The regulatory authority should be properly resourced in order to meet these responsibilities effectively, and a certain critical mass is required. This includes having access to legal and accountancy advice from sources which do not suffer from a conflict of interest. Regulatory authorities should have their own source of stable ring-fenced income, independent from Government or other political control and influence. This income is often raised from the industry in some way.

12. As stated in the paper 'The Supervision of the Banking, Insurance, and Securities Sectors', resources should be allocated 'in line with the structure, scale, and complexity of activity. The funding of the regulatory regime should not be based on the direct benefit derived by the OT Government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision'.

(v) Liabilities

13. Regulatory authorities are normally subject to statutory immunity from prosecution, in order to allow them to conduct their regulatory functions more effectively. Other jurisdictions are more likely to recognise this immunity if the regulatory authority matches up to international standards, in the ways outlined above. The converse is also true.

14. Properly resourced regulatory authorities which perform their functions in the ways envisaged by the documents mentioned in paragraph 2 are also much less likely to get into the sorts of situation where their actions might be subject to legal challenge. For example, the regulatory authority should be able to demonstrate that any problems did not arise as a result of substandard regulation.

INTERNATIONAL CO-OPERATION

INTRODUCTION

1. By their very nature, offshore centres conduct business which is linked with that in other financial centres. For this reason, it is important that offshore centres cooperate fully with requests for assistance from authorities in other jurisdictions. This includes both regulatory and law enforcement authorities. The types of assistance referred to in this paper do not include co-operation relating to fiscal matters.

2. The White Paper on Britain and the Overseas Territories explains that one of "the key components of the regulatory package we wish to see in place by the end of 1999" is "powers to ensure that, whatever the secrecy laws, regulators and law enforcement in those Overseas Territories with financial sectors can cooperate properly with their overseas counterparts, including on investigation and enforcement matters".

3. Assistance should extend to;

(i) Regulatory authorities sharing confidential regulatory information held on file or obtainable from licensed bodies.

(ii) Regulatory authorities obtaining information by compulsion from unlicensed bodies, and obtaining client information by compulsion from licensed bodies (where clients refuse to disclose this information voluntarily).

(iii) All such exchanges of information between regulatory authorities to take place under cover of a bilateral Memorandum of Understanding signed by each party, setting out the terms and conditions of assistance, including that the confidentiality of information provided must be safeguarded.

(iv) Law enforcement authorities providing assistance to their foreign counterparts covering all financial crimes (not just those related to money laundering or drugs-related offences), extending to investigative assistance before court proceedings have been issued, and providing for evidence to be obtained on their behalf.

OT regulatory authorities allowing information disclosed to a foreign regulatory authority to be disclosed in turn by them to a foreign law enforcement authority, but only with the OT's prior consent, which may extend to placing conditions on how that information might be used.

GATEWAYS: A PRECONDITION FOR INFORMATION EXCHANGE

4. Where confidential information is exchanged with a foreign authority, or between different authorities within the same jurisdiction, confidentiality should be safeguarded. Confidential information should only be exchanged where provided for in law. Confidential information should only be passed to *bona fide* authorities which can safeguard its confidentiality, and these safeguards should be established in law. Similarly, legislation in Overseas Territories should provide OT authorities with the power to safeguard the confidentiality of information they may have received from foreign authorities.

5. All Overseas Territories should have in place statutory 'gateways' which enable confidential information to be exchanged with foreign authorities. This would include all forms of information of interest to the authorities, including information relating to individuals, bank accounts, trusts, and companies. 'Gateways' legislation should override any secrecy and confidentiality provisions in OT law, to the extent that it should allow confidential information from all sources to be passed to a foreign authority, as long as that authority could in turn safeguard its confidentiality.

6. It is possible that foreign regulatory authorities might be compelled by Court order in their country to disclose confidential information obtained from an OT authority. In these circumstances, the OT authority's prior consent should be sought before any confidential information is disclosed to the Court. If such consent is not forthcoming, the Court should be made aware by the foreign authority that any compulsion to disclose may damage relations between regulatory authorities, to the detriment of future regulatory co-operation, and that this would not be in the public interest.

CO-OPERATION BETWEEN REGULATORY AUTHORITIES

(i) Types of co-operation

7. Gateways *per se* do not provide for adequate co-operation. They simply allow confidential information to be exchanged. Gateways need to be supplemented by powers which enable OT authorities to obtain information (either for their own purposes, or on behalf of foreign authorities), and subsequently to exchange this with foreign authorities.

(i) Supervisory information

8. OT regulatory authorities should be able to obtain, in the course of their normal duties, information relating to the supervision of licensed firms and persons. OT regulatory authorities should be able to exchange this information with their foreign counterparts.

(ii) Voluntary testimony

9. Representatives from a foreign regulatory authority should be allowed to visit an OT with the consent of the OT regulator, and take testimony from individuals and firms who voluntarily consent to being questioned by a foreign regulatory authority. Before approving a request to take voluntary testimony, the OT regulator should be satisfied (i) that the request comes from a *bona fide* foreign regulatory authority, and relates to their regulatory responsibilities, (ii) that the request relates to a specific line of investigation, and (iii) that the confidentiality of any information provided will be safeguarded.

(iii) 'Compulsory' powers

10. These are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. OT regulators should be able to exercise these powers in order to satisfy a request for

assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT. Following discussions at the past three Attorney Generals' Conferences, a draft Model Ordinance providing for compulsory powers is now well developed (attached at Annex B).

11. Annex A provides more details on how these powers would operate in practice. Because individuals and firms are *compelled* to provide information, there are tight constraints and conditions on the use of these powers, and OT regulatory authorities would have discretion in deciding whether to use them on behalf of an overseas authority. It is worth noting here that;

(i) Compulsory powers should only be used in certain specific circumstances. Incoming requests for information, which will require the use of OT compulsory powers to obtain it, should be vetted by the regulatory authority's lawyers (or an OT Magistrate/Court) within a specific time frame, in order to verify that compulsory powers may be used. Information obtained by compulsion may also be vetted by the regulatory authority's lawyers before final disclosure to a foreign authority;

(ii) Information obtained by compulsion should not be used as evidence against the provider in any subsequent criminal proceedings. The OTs will wish to decide whether to preclude it being used as criminal evidence against third parties;

(iii) Compulsory powers are used only at the very early stages of an investigation, when the investigator does not know whether criminal activity is at hand. Compulsory powers should no longer be used if/when it becomes clear that only criminal activity is involved, and hence that the investigation should be taken forward by the law enforcement authorities (once a suitable request for assistance has been made through other channels);

(iv) Strict terms and conditions on the use of compulsory powers should ensure that they cannot be abused to go on 'fishing trips', that the Overseas Territories retain discretion over their usage, and that they should not be used when it would be more appropriate to go though other channels (eg Mutual Legal Assistance Treaties (MLATs)).

12. Subject to these conditions, information obtained by compulsion may be disclosed to the law enforcement authorities, who as a result may seek to obtain criminal evidence (via other channels). Information obtained by compulsion may help indicate where criminal evidence may be obtained, ie may lay the ground for further requests for assistance via other channels by foreign law enforcement authorities.

13. In summary, these powers are used to uncover facts during the very early stages of an investigation, before it is clear what has taken place, in order to gain a picture of what happened. When it has become clear what happened, the authorities may choose whether to take no action, whether to take disciplinary action, whether to consider civil proceedings, or whether to consider criminal proceedings. Criminal evidence would need to be obtained via other channels (ie agreements between law enforcement authorities) in order to pursue a criminal prosecution. In the UK's experience, compulsory powers are rarely used on behalf of a foreign authority (about ten times per year).

(ii) Memoranda of Understanding

14. It is common practice between regulatory authorities for the terms and conditions of information exchange and investigative assistance to be set out in a Memorandum of Understanding signed between the authorities which will be co-operating with each other. Memoranda of Understanding usually require requests for assistance to be framed in terms of the specific activities which are being investigated by the foreign jurisdiction - eg they can prevent authorities going on 'fishing trips' in another jurisdiction.

Memoranda of Understanding should only provide for the exchange of confidential information when the foreign regulatory authority has demonstrated that they will be able to safeguard the confidentiality of information provided by the OT regulator. Memoranda of Understanding should specify explicitly how confidentiality will be safeguarded, and should set out the terms and conditions of onward disclosure, eg to a foreign law enforcement authority. It is common to allow a foreign regulatory authority to disclose information obtained (eg from an OT regulator) to another foreign authority, but only with the consent of the OT regulator in this example. Memoranda of Understanding should specify what terms and conditions apply to the use of compulsory powers, and this may include specifying how information provided may be used.

16. Memoranda of Understanding are not legally binding documents, nor are they any form of legislation. They are simply an agreement between two regulatory authorities. For this reason, they tend to be tailored to the degree and nature of assistance available in each jurisdiction. Separate MoUs tend to apply to each sector (ie banking, securities, and insurance), although eg an MoU in the securities field would still provide for the exchange of information on bank account details (where this was connected to a breach of regulations or laws concerning securities).

17. Further precise details on international standards relating to Memoranda of Understanding are set out in publications by the Basle Committee, IOSCO, and the IAIS. The IAIS paper 'Insurance Principles, Standards, and Guidance Papers' includes in an Annex a model MoU in the field of insurance. IOSCO have published separate guidance titled 'Principles for Memoranda of Understanding'.

18. An Overseas Territory regulatory authority may still exchange information with a foreign authority if a Memorandum of Understanding is not in place. The terms and conditions of such exchange would need to be agreed on a case by case basis. Memoranda of Understanding essentially provide a framework which allows information to be exchanged without the terms and conditions of such exchange having to be negotiated on each separate occasion. Memoranda of Understanding are therefore more relevant between jurisdictions which exchange regulatory information regularly.

CO-OPERATION BETWEEN LAW ENFORCEMENT AUTHORITIES

(i) Types of co-operation

19. Assistance should be available to foreign law enforcement authorities in relation to all forms of financial crime, rather than just drugs-related offences or money laundering. This would include fraud, insider-dealing, and market manipulation. An OT should be able to provide assistance even though the activity under investigation might not be a criminal offence in that OT. In these circumstances, OT law enforcement authorities will wish to consider whether there is a good reason to provide assistance, or whether it would be in the public interest not to provide assistance.

20. OT law enforcement authorities should be able to provide investigative assistance, and should be able to obtain evidence on behalf of their foreign counterparts. As with regulatory co-operation, assistance should be provided in response to specific requests. Investigative assistance should be made available before court proceedings have been issued, and ideally without the prior need for a Treaty to exist between the countries in question.

21. These objectives would be satisfied if the Overseas Territories were to adopt measures equivalent to those in the UK's Criminal Justice (International Co-operation) Act 1990, which provides for UK authorities to co-operate with judicial and prosecuting authorities in other countries in criminal proceedings and investigations. Many OTs have already introduced equivalent legislation. It is for OTs to decide whether they wish to satisfy the objectives specified here by adopting equivalent legislation or by choosing other means. It is worth noting here that assistance should be available to all *bona fide* foreign law enforcement authorities with genuine requests.

22. It is not common for Memoranda of Understanding to be signed between law enforcement authorities, if only because the types of co-operation required are often provided for by international Treaties. Nevertheless, there is nothing to prevent Memoranda of Understanding from being adopted, especially if OT law enforcement authorities wish to adopt bilateral agreements specifying exactly how assistance might be provided.

23. Memoranda of Understanding are generally easier and quicker to devise and modify than bilateral Treaties. For this reason, an OT is unlikely to be able to co-operate effectively in the ways envisaged with a wide range of countries over a wide range of areas if it seeks to negotiate, sign, and manage a set of bilateral Treaties with all foreign law enforcement authorities which seek assistance.

(ii) Seizing assets

24. International co-operation should extend to tracing, freezing, and confiscating the proceeds of crime, and their value, on behalf of overseas authorities. Powers to trace assets for authorities in other jurisdictions should be exercisable regardless of banking secrecy and, preferably, on an agency to agency basis as well as through central authority channels. Powers to restrain and confiscate assets which represent the proceeds of crime should be on an all crimes basis, as envisaged in the 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime.

25. No assets should be immune from seizure, either by virtue of OT laws or other arrangements providing for asset protection, or by virtue of arrangements (eg in trust instruments) which require assets to 'flee' to another jurisdiction when there is a chance that they might be seized. These arrangements for asset seizure should apply to all financial crimes, ie not just drugs-related crimes or money-laundering, even though a crime may not have been committed in an OT.

CO-OPERATION BETWEEN DIFFERENT TYPES OF AUTHORITY

26. The G7 have recently adopted a set of ten principles concerning the extent to which regulatory and law enforcement authorities should work with each other, including when different types of authority are based in different jurisdictions. In general, different types of authority (regulatory and law enforcement) should be able to exchange information with each

other and to provide each other with investigative assistance, subject to specific terms and conditions set out in Memoranda of Understanding. This does not imply that regulatory authorities should take on the role of 'international tax policemen'.

27. In practice, an OT regulatory authority would assist a foreign law enforcement authority by passing information to a foreign regulatory authority, and allowing them (with prior consent) to disclose this to a law enforcement authority in their jurisdiction. Domestic regulatory authorities do not tend to deal directly with foreign law enforcement authorities.

If this arrangement is to work effectively, there need to be effective gateways and working relations between regulatory and law enforcement authorities in the same jurisdiction.

28. This should not, however, prevent OT regulatory authorities from dealing directly with foreign regulatory authorities which also happen to possess certain law enforcement and prosecuting responsibilities. In this instance, the Memorandum of Understanding between respective regulatory authorities would need to specify clearly how any information disclosed might be used.

ANNEX A: COMPULSORY POWERS (OR INVESTIGATIVE POWERS)

A1. Compulsory powers are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. In the context of regulatory co-operation, OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT.

A2. Compulsory powers may be used to obtain information from both licensed and unlicensed firms and persons. This includes ordinary members of the public as well as all financial institutions, companies, and trusts. Compulsory powers may be used to obtain all types of information, including details of beneficial ownership, personal bank details, and personal telephone records.

A3. Compulsory powers override all other secrecy and confidentiality provisions in law - ie they may be used to obtain information from bank accounts, companies, and trusts, even if other laws declare that all such information should not be disclosed. Confidential information would only be disclosed to a foreign regulatory authority if they could safeguard its confidentiality.

Use of compulsory powers

A4. These wide-ranging powers are used at the very early stages of an investigation to gain an understanding of what happened - ie which activities took place where, and who was involved with what. Compulsory powers are used infrequently, as regulatory authorities normally have a clear understanding of what happened, especially where 'know your customer' guidance is actively implemented and licensed firms and persons are willing to assist the authorities.

A5. Compulsory powers are used to undertake fact finding investigations, rather than to obtain criminal evidence. Information obtained by compulsion may be used by the regulator to take disciplinary or civil action. Because information is obtained by compulsion, it cannot be used as evidence in criminal proceedings against the provider.

A6. Furthermore, the 'rules of evidence' which exist in most countries normally prescribe how evidence may be obtained, and this tends to involve questioning under police caution: ie the very nature of compulsory powers normally prevents any information obtained from being used as evidence in criminal proceedings.

OT regulatory authorities may in addition wish to specify in Memoranda of Understanding signed with foreign counterparts that information obtained by compulsion cannot be used as evidence in criminal proceedings.

A7. Compulsory powers should not be used to provide assistance to a foreign regulatory authority if it would be more appropriate to use other channels (eg Mutual Legal Assistance Treaties (MLATs)). It is for the requested authority to determine the appropriate channels in line with commitments entered into in any MoUs or Treaties. In practice, compulsory powers should only be used when it remains possible that civil action may be taken as a result of the investigation at hand. As soon as it becomes clear during the investigation that the authorities are faced with only criminal activity, compulsory powers should no be longer used. At this stage, the law enforcement authorities should be left to pursue a criminal investigation (and overseas law enforcement authorities should seek assistance via other channels).

A8. Within this framework, compulsory powers can still be used to assist law enforcement authorities, but only at the very early stages of an inquiry, when it remains unclear what happened, and hence whether civil or criminal sanctions (or none) would be appropriate. Information obtained by compulsion essentially lays the ground for criminal investigations undertaken

by law enforcement authorities, should it transpire that criminal activity is at hand. Compulsory powers would be used before a foreign law enforcement authority is in a position to make a request for assistance from an OT law enforcement authority (eg via MLAT).

A9. In this limited sense, the use of compulsory powers may lead to criminal prosecutions. In practice, an OT regulatory authority would not deal directly with a foreign law enforcement authority. Instead, OT regulatory authorities would deal with their foreign counterparts, and then allow (with prior consent) their foreign counterparts to disclose information received to foreign law enforcement authorities.

Who investigates?

A10. Investigations are usually undertaken by the domestic regulatory authority on behalf of the overseas regulator. It is normal for these powers to be vested with the head of the regulatory authority, although an alternative may be to vest them with the Governor or Minister of Finance (depending on who is ultimately responsible for regulation of the offshore sector).

A11. Whoever holds these powers may authorise an officer of his or any other competent person to exercise them. If an OT so wishes, it is possible for an OT regulator to allow an overseas regulator to operate as an authorised agent of theirs and use these powers directly. The decision on who to appoint is normally made on a case by case basis.

A12. Payment of the costs of exercising these powers can be made a condition for providing assistance. This normally happens when the balance of requests tends to be one-sided, rather than domestic and overseas authorities seeking broadly equivalent assistance from each other.

Constraints and discretion in exercising compulsory powers

A13. The exercise of investigative powers after a request is not inevitable, nor is the disclosure of information obtained by their exercise. The powers can only be used to assist an overseas authority having specified regulatory functions, and then only for the purposes of those functions. Assistance should be provided when there is a good reason to do so (this hurdle is normally relatively easy to satisfy).

A14. The information which is obtained through the exercise of investigative powers can be disclosed only if a gateway exists. If there are concerns about how the confidentiality of the information provided will be safeguarded once in the hands of the overseas regulator, or if, as a result of the investigation, doubts have arisen about the authenticity of the overseas regulator's claim to need the information for its regulatory functions, the OT regulatory authority should discuss its concerns with the foreign regulatory authority before disclosing any information.

A15. Assistance should be provided in response to individual requests, which should specify what information is sought and the purpose for which it is sought, including details of the laws, rules or regulations which it is alleged have been breached and of the conduct which gives rise to the breach. The draft model OT Compulsory Powers Ordinance (attached) requires that the following factors be taken into account when deciding whether to exercise compulsory powers on behalf of a foreign authority;

> Whether corresponding assistance would be given to the OT;
>
> Whether the inquiries relate to a breach of law which has no parallel in the OT (although assistance may still be provided in these circumstances, if there is a good reason to do so);
>
> The seriousness of the matter in question, the importance to the investigation of exercising compulsory powers, and whether assistance could be obtained by other means (eg MLATs);
>
> Whether it is in the public interest to provide assistance.

A16. Each request for assistance should be vetted by the OT regulatory authority to ensure that it is made by a foreign authority which has the necessary functions and that the request is made for the purpose of its regulatory functions. The requesting authority must demonstrate that a substantial line of enquiry is being pursued - its request should not be a "fishing trip" for information. In practice, the OT regulatory authority would also vet all information obtained by compulsion, to ensure that information disclosed to a foreign authority relates to the specific request made. This vetting would normally be undertaken by the OT regulatory authority's legal advisers. The draft model OT Compulsory Powers Ordinance also provides for an OT Magistrate or Court to approve the use of compulsion, within a short time frame. Under the draft model OT Compulsory Powers Ordinance, it is a criminal offence not to provide information under the exercise of compulsory powers.

ANNEX B: DRAFT COMPULSORY POWERS MODEL ORDINANCE

A Bill entitled:

An Ordinance to make provision for assisting overseas regulatory authorities to obtain information:

ENACTED BY the Legislature of [the Caribbean Overseas Territory] as follows:

1. This Ordinance may be cited as the ******** Ordinance, 1998.

2. In this Ordinance:

"competent authority" means any authority specified in [the Schedule to this Ordinance] [an Order made by the Governor];

["Director" means the Director of Financial Services;]

"foreign regulatory authority" means an authority which, in a country or territory outside [the Caribbean Overseas Territory], exercises functions corresponding to any functions of a competent authority under any Ordinance, or exercises any function [prescribed for the purposes of this section by an Order made by the Governor, being a function] which in the opinion of the Governor relates to companies or financial services;

"Governor" means the Governor in Council;

"regulatory functions" means functions of a competent authority under any Ordinance or any functions corresponding to such functions, and any other functions relating to companies or financial services, not being the functions of assessing, imposing or collecting taxes.

3. (1) Subject to subsection (2), the powers conferred by section 4 are exercisable by the [Director] for the purpose of assisting a foreign regulatory authority which has requested assistance in connection with inquiries being carried out by it or on its behalf.

(2) The [Director] shall not exercise the powers conferred by section 4 unless he is satisfied that the assistance requested by the foreign regulatory authority is for the purposes of its regulatory functions.

[(2A) The [Director] may decline to exercise the powers conferred by section 4 unless he is satisfied that information furnished pursuant to the exercise of those powers will not be used in any criminal proceedings against the person furnishing it (other than proceedings for an offence under section 7 or for an offence of perjury, or for any like offence).]

(3) In deciding whether to exercise those powers, the [Director] may take into account, in particular:

(a) whether corresponding assistance would be given in the relevant country or territory to an authority exercising regulatory functions in [the Caribbean Overseas Territory];

(b) whether the inquiries relate to the possible breach of a law, or other requirement, which has no close parallel in [the Caribbean Overseas Territory] or involves the assertion of a jurisdiction not recognised by the [the Caribbean Overseas Territory];

(c) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in [the Caribbean Overseas Territory] and whether the assistance could be obtained by other means;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

[(4) For the purposes of subsection (3)(a), the [Director] may require the foreign regulatory authority requesting assistance to give a written undertaking, in such form as the [Director] may determine, to provide corresponding assistance to an authority exercising regulatory functions in [the Caribbean Overseas Territory].

(5) Where a foreign regulatory authority fails to comply with a requirement made under subsection (4), the [Director] may refuse to provide the assistance sought.]

(6) The [Director] may decline to exercise the powers conferred by section 4 unless the foreign regulatory authority undertakes to make such contributions towards the costs of their exercise as the [Director] considers appropriate.

(7) In subsection (3)(a), "relevant country or territory" means the country or territory from which the request for assistance is made.

4. (1) Where in accordance with section 3 the [Director] is satisfied that assistance should be provided pursuant to a request by a foreign regulatory authority, he may in writing direct any person -

(a) to furnish him with information with respect to any matter relevant to the inquiries to which the request relates;

(b) to produce any documents relevant to those inquiries; or

(c) to give him such assistance in connection with those inquiries as the [Director] may specify.

[(3) The [Director] may examine a person on oath and may administer an oath accordingly.]

[(3A) Where a person fails to comply with a direction given under subsection (1) within three days from the date of the direction or such longer period as the [Director] may permit, the [Director] may apply to [a Magistrate] [the court] for an order requiring the person to comply with the direction.

(3B) Where pursuant to a direction given under subsection (1) the [Director] considers it necessary to examine a person on oath, [the Director] may apply to [a Magistrate] [the court] to have that person examined by [the Magistrate] [the court] and the results thereof transmitted to the [Director].

(3C) [A Magistrate] [the court] shall process an application under subsection (3A) or (3B) within seven days and, in the case of subsection (3B), [he] [it] shall transmit the results of the examination to the [Director] within a reasonable period not exceeding fourteen days.]

(4) Where documents are produced pursuant to this section the [Director] may take copies or extracts from them.

(5) A person shall not under this section be required to disclose information or produce a document which he would be entitled to refuse to disclose or produce on grounds of legal professional privilege in proceedings, except that a [lawyer] [barrister or solicitor] may be required to furnish the name and address of his client.

(6) Where a person claims a lien on a document, its production under this section is without prejudice to his lien.

In this section "documents" includes information recorded in any form; and, in relation to information recorded otherwise than in legible form, the power to require its production includes power to require the production of a copy of it in legible form.

5. (1) The [Director] may:

(a) [seek the assistance of the Commissioner of Police in the exercise of his powers under this Ordinance; or]

(b) authorise an officer of his or any other competent person to exercise any of those powers.

(2) No such assistance shall be sought or authority granted except for the purpose of investigating -

(a) the affairs, or any aspect of the affairs, of a person

specified by the [Director]; or,

(b) a subject matter specified by the [Director];

being a person who, or a subject matter which, is the subject of the inquiries being carried out by or on behalf of the foreign regulatory authority.

(3) No person shall be bound to comply with a requirement imposed by a person exercising powers by virtue of an authority granted under this section unless he has, if required, produced evidence of his authority.

(4) Where the [Director] seeks assistance or grants an authority under subsection (1), the assistance or authority shall be provided or executed in such manner as the Director may determine; and where the Director grants such an authority to a person other than one of his officers, that person shall make a report to the [Director] in such manner as he may require on the exercise of that authority and the results of exercising it.

6. (1) No information which

(a) is supplied by a foreign regulatory authority in connection with a request for assistance, or

(b) is obtained by virtue of the exercise of powers under this Ordinance, shall, except as permitted by subsection (2), be disclosed for any purpose by the primary recipient, or by any person obtaining the information directly or indirectly from him, without the consent of the person from whom the primary recipient obtained the information and, if different, the person to whom it relates.

(2) Information to which subsection (1) applies may be disclosed:

(a) to any person with a view to the institution of, or otherwise for the purpose

of:

(i) criminal proceedings;

(ii) disciplinary proceedings relating to the exercise by a barrister,

solicitor, auditor, accountant, valuer or actuary of his professional duties;

(iii) disciplinary proceedings relating to the discharge by a public [servant]

[officer] of his duties;

(b) for the purpose of carrying out any duty imposed under any law in force in

[the Caribbean Overseas Territory] or by any international agreement to

which [the Caribbean Overseas Territory] is a party;

[(c) on the order of a court of competent jurisdiction for the purposes of

any criminal or civil proceedings;]

(d) for the purpose of enabling or assisting a competent authority to discharge

any of its functions under any Ordinance;

(e) to the [Governor/Attorney General/public officer approved by the Director] [in the public interest];

(f) if the information is or has been made available to the public from other

sources;

(g) in the form of a summary or collection of information framed in such a

way as not to enable the identity of any person to whom the information relates to be ascertained;

(h) to a foreign regulatory authority for the purpose of its regulatory functions.

(3) In subsection (1) "the primary recipient" means, as the case may be -

(a) the [Director];

(b) any person authorised under section 5; or

[(c) the Commissioner of Police or any of his officers.]

7. (1) A person who

(a) without reasonable excuse, refuses or fails to comply with any [direction given by the [Director]] [order of [a Magistrate] [the court]] under section 3;

(b) intentionally furnishes false information in purported compliance with any such [direction] [order];

(c) with intent to avoid the provision of this Ordinance, destroys, mutilates, defaces, secretes or removes any document;

(d) otherwise wilfully obstructs any inquiry to which a request from a foreign regulatory authority relates; or

(e) contravenes section 6;

commits an offence.

(2) A person who commits an offence under this section is liable .....

8. No suit shall lie against the [Director] or any person acting under his authority for anything done by him, in good faith, in the exercise of any power or the performance of any function under this Ordinance.

9. This Ordinance shall come into [force] [operation] on such date as the Governor may by proclamation appoint.

MONEY LAUNDERING

INTRODUCTION

1. Money laundering is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises. It is, in effect, the interface between the illegal business sector and the financial sector. Estimates of the size of the phenomenon are hard to come by, but it is generally agreed that it could be in the region of 5% of GDP of the average country.

2. The activity is one of considerable concern for many reasons. If the proceeds of crime are allowed to be lodged unhindered in financial institutions, criminals can gain influence over the institutions and, perhaps eventually control them. Where criminal proceeds are used to buy legitimate businesses, competitors find themselves unable to compete and are driven out of business. Unchecked, money laundering can destabilise financial institutions, sectors and, in certain cases, entire economies. Economic crime can damage financial markets and, thus, the reputation and health of a nation as a whole. It is the concern generated by these implications that have galvanised the international community into making concerted efforts to tackle money laundering.

3. These efforts are highlighted by the following initiatives:

* the 1988 UN Drugs Convention requires parties to criminalise drug money laundering;

* the Financial Action Task Force (FATF) set up in July 1989 by the G7 specifically to develop and promote policies to combat money laundering.

* the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime November 1990;

* the EC Money Laundering Directive of June 1991 requires Member States to prevent the use of their financial systems for money laundering;

* the Caribbean Financial Action Task Force (CFATF) the first regional body to follow the FATF.

4. The White Paper on Britain and the Overseas Territories (Partnership for Progress and Prosperity) noted that the Caribbean Overseas Territories are, in particular, a potential target for money launderers. The OTs should, therefore, have in place comprehensive measures to combat money laundering.

5. The White Paper checklist acknowledged, however, that this is an area in which the OTs have already made good progress. Most have now introduced "allcrimes money laundering legislation". This legislation must, however, be enforced and reviewed regularly. To their credit, all of the OTs are members of the Caribbean Financial Action Task Force and either have, or will shortly undergo, mutual evaluations.

6. The following guidance explains what HMG means by "comprehensive measures to combat money laundering".

INTERNATIONAL STANDARDS

The FATF 40 Recommendations:

7. The 40 Recommendations set the basic framework for anti-money laundering efforts and are designed to have universal application. The principles cover the criminal justice system, law enforcement, the financial system and its regulation and international co-operation. The essential components of the 40 Recommendations are as follows:

* Each country should implement a general framework which ratifies the Vienna Convention, and increases multilateral co-operation on money laundering cases.

* Each country should criminalise money laundering in relation to serious offences, not merely drug money laundering.

* Countries should also put in place measures to enable the tracing, freezing and seizing of criminal assets and the ultimate confiscation thereof.

* The following should be required of all financial institutions, whether they be bank or non-bank institutions:

customer identification "know your customer"

record keeping 5 years

special attention to complex/unusual/large transactions

immunity from prosecution if report suspicion in good faith

internal systems including training and designation of

compliance officer

application of these requirements to foreign branches

* Each country should improve spontaneous or "upon request" international information exchange relating to suspicious transactions. This requirement is subject to strict safeguards necessary to ensure consistency with national and international provisions on privacy and data protection.

* Different definitions and standards between jurisdictions should not affect the ability or willingness of countries to provide each other with mutual legal assistance.

* There should be procedures regarding the use of compulsory measures including the production of records by financial institutions.

OTHER RELEVANT STANDARDS

CFATF additional 19 Recommendations:

8. In June 1990 representatives of Caribbean and Latin American States formulated a further 19 Recommendations specifically tailored to regional laws and circumstances. These acknowledged the need to devote adequate resources to this area, the need for competent authorities to specialise in it and that improvements would be ' required to legal systems to enhance the regulation and the role of the financial sector and to improve international co-operation. In particular the CFATF Recommendations urged members to:

consider the practical evidentiary complications of limiting money laundering to only certain predicate crimes.

* criminalise conspiracy and/or aiding or abetting drug trafficking and money laundering offences.

* to consider making money laundering an offence both where the offender knew or ought to have known the origin of the funds.

* to make money laundering an offence no matter where the predicate offence took place.

* to acknowledge that the fact that a financial adviser is an attorney is insufficient reason to invoke attorneyclient privilege.

EU Money Laundering Directive:

9. Although this has no direct impact on the OTs, it is relevant in so far as it informs the UK law. The EU Money

Laundering Directive of 10 June 1991 (91/308/EEC) requires Member States to prevent the use of their financial systems for money laundering. The EU suggests three main steps to combat money laundering: criminalise it; take measures to identify laundered proceeds with a view to confiscation; pass laws and establish systems to prevent the proceeds of crime being laundered in the first place.

10. The Directive also sets out requirements to be placed on the credit and financial institutions (as defined) of the Member States' jurisdictions. This includes customer identification and retention of records, relating to identification and transactions, for a period of five years. The Directive goes on to require Member States to place a requirement on such institutions to inform the authorities about suspected money laundering activity.

The UK law and practice:

11. The UK implemented the EU Directive by means of the Criminal Justice Act 1993, the Money Laundering Regulations 1993 and earlier legislation. The principal money laundering offences are set out in the Prevention of Terrorism (Temporary Provisions) Act 1989 and the Drug Trafficking Act 1994. The Criminal Justice Act 1988, as amended, contains the money laundering offences relating to the proceeds of crimes other than drug trafficking and terrorism. These are defined as all indictable offences, other than those covered by the 1989 and 1994 Acts, plus the summary offences set out in Schedule 4 to the 1988 Act. The latter include certain lucrative offences relating to sex establishments and the supply of unclassified videos.

12. The principal money laundering offences have a dual purpose. Firstly, to criminalise and so suppress money laundering activity. Secondly, to encourage the reporting of suspicious transactions to the authorities. In this second respect, the offences help to protect the integrity of financial institutions by deterring criminals from lodging proceeds in them, and also help to provide the police with new investigative leads.

Criminal Justice Act 1988, as amended by the Criminal Justice Act 1993:

13. The money laundering offences created by this legislation are as follows:

Assisting another to retain the proceeds of crime: to commit this offence, one must know or suspect that the person in question is or has been engaged in crime, or has benefited from it.

Acquiring, Possessing or using another's proceeds of crime: the offence only applies where the launderer acquires, possesses or uses the property for inadequate "consideration,' (payment). Thus, if one pays full value for the property one does not commit the offence. The provision of goods or services which are of assistance in criminal conduct is not regarded as "consideration".

Concealing another person's proceeds of crime: This includes concealing or disguising property; or converting or transferring property or removing it from the jurisdiction. Carrying out these activities must be for the purpose of assisting somebody to avoid prosecution for a relevant offence or the making of a confiscation order against him/her. Unlike the above offences, all that is required here is "reasonable grounds for suspicion". Thus the prosecution need only prove that the person laundering the proceeds **should have suspected.**

Laundering one's own proceeds: This includes the same activities as concealing another person's proceeds and one must conceal, disguise, convert, transfer or remove property from the jurisdiction for the purpose of avoiding one's own prosecution for a relevant offence or the making of a confiscation order against oneself.

14. The penalties for all of the above offences are fourteen years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction (currently £5,000).

15. The legislation also includes the following offences:

Tippingoff offences: These apply when a money laundering investigation is being, or is about to be, conducted, and where a suspicious transaction report has been made, or a suspicion of money laundering has been disclosed to the authorities. The offence can be committed where one knows or suspects that an investigation is being conducted, or is about to be, or a disclosure has been made.

16. The penalties for tippingoff are five years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction.

The Money Laundering Regulations 1993:

17. Another essential part of the UK's antimoney laundering defences are the Money Laundering Regulations. They require financial institutions to put in place systems to deter money laundering and to assist the authorities to detect money laundering activities. The Regulations apply to:

* all banks, building societies and other credit institutions,

* all individuals and firms authorised to conduct investment business under the Financial Services Act 1986,

* all insurance companies covered by the EC Life Directives, including the life business of Lloyds of London,

* all other undertakings carrying out any of the range of financial activities listed in the annex to the Second Banking Directive (89/646/EEC, SI 1992,3218). This includes bureaux de change and money transmission services.

18. The Regulations establish criminal offences for those who fail to ensure adequate systems are in place and maintained. Thus, the Regulations require:

procedures to ensure identification of customers, maintenance of records relating to identification and transactions, or such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering;

* appropriate measures to be taken from time to time to make employees who handle relevant financial business aware of the procedures and the money laundering statutes;

* provision of training for those employees from time to time in the recognition and handling of transactions which may be money laundering.

19. Where an offence is committed by a body corporate, partnership or unincorporated association, the directors and managers and certain other people may be guilty of the offence as well. Penalties for contravention of the Regulations are two years imprisonment and an unlimited fine on indictment and a fine not exceeding the statutory maximum on summary conviction.

Money Laundering Guidance Notes:

20. In addition to the above, the British Bankers Association have produced guidance notes for the industry in association with the Building Societies Association and the law enforcement authorities. Similar guidance notes have also been produced for the insurance and investment business sectors.

COMPLIANCE WITH THESE STANDARDS

21. With regard to the OTs, we have encouraged the OTs to put in place measures equivalent to those in the UK. Most have now implemented the primary legislation. However, work on the essential supporting measures still needs to be completed.

Regulations:

22. Many OTs have opted to implement voluntary codes of practice rather than an equivalent to the UK Money Laundering Regulations 1993 (the Regulations). **To be effective these need to be placed on a statutory footing** providing for criminal offences in the event that monitoring and reporting systems are not created and maintained.

23. Effective operation of the antimoney laundering legislation relies on the vigilance of financial institutions and the reporting of suspicious transactions. While the requirement to put in place monitoring and reporting systems is voluntary, the risk of commercial interest frustrating the intent is concrete. Placing these requirements on a mandatory footing would enable the OTs to ensure that the supporting mechanisms for their money laundering defences could be enforced. It would also send a clear signal to the financial sector that "all money is not simply money", and that certain types of financial activity were unacceptable.

Resources and enforcement:

24. It is clear from the above that the creation of anti-money laundering defences requires considerable input of resources on the part of the financial institutions. This, however, is only one part of the equation. There is little point in requiring the financial sector to report suspicious transactions if there is an inadequate ability on the part of law enforcement to respond. This means that OT Governments must devote considerable resources to ensuring that the law enforcement capacity for

analysing suspicious transaction reports and, where appropriate, acting on them is sufficient. This will apply not only to reports submitted by institutions operating within the jurisdiction, but also to requests for assistance on money laundering investigations from foreign jurisdictions. It is, therefore, essential that the Financial Investigation and Intelligence Units in the OTs are adequately staffed with trained personnel capable of conducting financial investigations and analysis.

25. In addition, it will also be necessary to ensure that the Attorney Generals' Chambers and the judiciary in each OT are appropriately resourced and trained to handle the types of cases which may result from enforcement of the money laundering laws. Again, this relates not merely to prosecutions of offences within the OTs, but also to provision of assistance to foreign jurisdictions in pursuance of the antimoney laundering legislation. Where appropriate, HMG is willing to provide assistance on a short term basis. However, it will be for the OTs to ensure that they budget appropriately for these responsibilities in the future.

International co-operation and confiscation:

26. It goes without saying that a great deal of money laundering involves transactions spanning a number of jurisdictions. The more complex the transactions and the more jurisdictions involved, the harder it is for law enforcement to follow the money trail. The abolition of exchange controls in the late seventies and early eighties, and the rapid improvement in technology means that it is possible instantly to transfer money of any amount or denomination virtually anywhere in the world. Much criminal law is territorially based, and differs from jurisdiction to jurisdiction, so the investigation and prosecution of financial crime and money laundering are very dependent upon mutual legal assistance between states.

27. The confiscation and money laundering legislation which the OTs have been enacting enables many of them to co-operate in international asset tracing investigations, and in the restraint and confiscation of the proceeds of drug trafficking and other crime. Given the percentage of financial business in the OTs which has its origins in other jurisdictions, it is vital that these provisions for international cooperation are fully implemented and, when implemented, operate effectively. At a time when much attention is being focused internationally on offshore centres, it is in the OTs interests to ensure their reputation for being willing and able to assist in tracing, freezing and confiscating criminal proceeds is second to none.

28. HMG is mindful of OT concerns that they may invest considerable resources in providing investigative assistance in proceeds of crime cases, only for the assets to be confiscated elsewhere and retained by the confiscating jurisdiction. In our view, international asset sharing from which some OTs have benefited considerably in recent years provides the best way to ensure that the costs of international casework is shared equitably among cooperating jurisdictions. we strongly support the sharing of confiscated assets relating to all crimes, including drug trafficking, and are working internationally to promote progress in this area. We are happy to discuss continuing concerns about costs with the OTs, and have asked them whether they would be interested in having the Council of Europe Convention extended to their jurisdictions.

Fiscal offences:

29. International standards indicate that money laundering should be criminalised in relation to all serious crime, not merely drug trafficking. The principles leave the definition of serious crime to the individual jurisdictions. At the same time, however, **they also make it clear that such individual definitions should not affect the ability "or willingness" of countries to provide mutual legal assistance.**

30. In the UK we treat tax evasion as a serious crime so it is caught by our confiscation and money laundering legislation. We are aware that different jurisdictions treat specific tax offences in different ways. Experience suggests that this can create problems where money laundering investigations relate in some way to tax offences.

31. The "tax issue" can arise in two ways. First, the predicate offence to which the money laundering offence relates is a tax offence. Assume the predicate offence takes place in jurisdiction A and the money laundering offence takes place in jurisdiction B. A problem is created where the latter does not recognise the tax offence in question as a predicate offence to which its money laundering legislation applies. As a result it will not provide co-operation to jurisdiction A in its investigations. Second, the predicate offence may be another serious crime, such as drug trafficking. It is, however, disguised as a tax related problem to ease the process of laundering. Nonrecognition of tax offences, or non-cooperation on money laundering cases involving such offences can frustrate all sorts of criminal investigations. In either of these scenarios, the inability to cooperate where tax is, or appears to be, involved creates a loophole in the anti-money laundering defences which criminals will utilise.

32. Failure to provide adequate coverage for this issue in the antimoney laundering defences has two serious drawbacks. it makes it easier for criminals to get away with tax evasion, which we regard as a serious crime, and it undermines efforts to combat other forms of offending.

33. There is some concern that the inclusion of tax offences as predicate offences, for the purposes of the money laundering legislation, will place a requirement on financial institutions to know and understand the fiscal regimes in other jurisdictions. This is quite wrong. Under the money laundering offences one is only required to consider whether one has a suspicion of something which would be a crime in one's own jurisdiction. it is also argued that it is difficult or impossible to determine whether a transaction is indeed linked to drug trafficking, tax or any other specific crime. However, the financial institutions and their employees are not expected to investigate suspicions, but to disclose them. As noted above, in the case of the UK, this includes disclosing suspicions of tax evasion. It is worth noting, however, that cooperation on money laundering investigations involving tax offences does not necessarily require such offences to be made predicate. There may be other related offences which fall within the ambit of a jurisdiction's money laundering legislation.

34. There is also an argument that "there is no such thing as the laundering of money from tax fraud', on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime.

35. The UK's confiscation, money laundering and judicial co-operation legislation enables us to trace, freeze and confiscate the proceeds of tax evasion, or any other crime, on behalf of other jurisdictions. Where restraint and confiscation are concerned, the conduct overseas must correspond to an applicable offence in the UK. **However, much investigative assistance can be provided without any dual criminality requirement.** We can, and do, assist in foreign tax evasion cases, including cases where the conduct is not necessarily an offence in the UK.

36. As part of the efforts to combat money laundering, the UK is encouraging others to close loopholes. We would, therefore, encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able.

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3 (Copies of Guidance Notes to be provided to Consultants.) Back

4 Clive Briault: *The Rationale for a Single National Financial Services Regulator* - May 1999 Back

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We welcome your comments on this site.

Prepared 27 October 2000

Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda — Bermuda

1 Executive summary

1.1 Introduction

This is one of six reports we have issued covering the Caribbean Overseas Territories and Bermuda. This report deals with Bermuda.

Bermuda is Britain's oldest Overseas Territory and is a group of around 150 islands. It lies 917 km east of the coast of North Carolina. The total land area is 53.33 square km. The estimated population of Bermuda is 62,277 (at 1998). Its estimated GDP per capita in 1998-99 was US$ 39,454, with an estimated growth rate of 5.3%.

Offshore finance (especially reinsurance) and tourism are the two main pillars of the economy.

Constitutionally, Bermuda enjoys a large measure of self-government as an internally-governing Overseas Territory. Government is undertaken through a Governor who is appointed by the Crown, and through two legislative chambers, the House of Assembly and the Senate. The Governor retains responsibility for internal security, external affairs, defence and the police, but not for financial services.

1.2 Financial services in Bermuda

The most important financial services activity in Bermuda is insurance. Bermuda has an extensive international insurance sector comprising captive insurance companies, life insurance companies and some of the largest catastrophe reinsurance companies in the world, in addition to a modest domestic insurance market. Bermuda dominates the global captive insurance market with gross annual premiums of US$ 27 billion and total assets of US$ 115 billion. The Bermuda market is primarily comprised of captive and reinsurance business rather than being a significant retail market.

Bermuda has determined not to be a large-scale banking centre. As a result of this there are only three licensed banks in Bermuda. Of these, two provide a full range of retail, commercial and private banking services. Both institutions have an extensive network of subsidiaries and offices domestically and internationally. The third institution is mainly engaged in corporate and private banking, investment services and wholesale market placement of funds. There are also four deposit companies.

As at 31 March 2000 the total asset size of the banking sector was US$ 16.7 billion.

In respect of securities/investments business, legislation has only recently been enacted. By the end of June 2000, the completion of the transitional period for licensing existing businesses, 38 businesses had been granted investment business licences.

As at 31 March 2000 there were 1,301 collective investment schemes in Bermuda with US$ 36.7 billion in funds under management.

Company formation is effectively limited to lawyers and accountants, with the islands' two largest law firms making up the majority of applications. As at 31 March 2000 there were 10,771 active exempted companies and 2,526 active local companies.

As in most other jurisdictions, there is no requirement to register trusts in Bermuda or for them to produce audited accounts. Accordingly the level of trust activity is unknown, although it is believed by the Bermuda Monetary Authority ("BMA") to be substantial.

Bermuda also has its own stock exchange ("the BSX"). The BSX has 18 trading members and 4 listing sponsors. Typical daily trading volumes are approximately 30,000 shares in respect of domestic BSX business. Daily crosses from the New York Stock Exchange averaged 73 million shares per day during 1999.

1.3 Financial services regulation

Bermuda is one of the more mature territories we have reviewed in terms of regulatory structure and culture.

The responsibility for the overall licensing, regulation and supervision of financial activities in Bermuda is vested in the BMA. The only exception to this is in relation to insurance where the regulator is the Registrar of Companies.

The BMA is operationally independent of Government. The Company Registry is, however, part of the Ministry of Finance.

There is legislation in place covering the regulation of banking, insurance, mutual funds, trust service providers and securities/investment business. There is no specific regulatory legislation relating to company service provision.

1.4 **Summary of principal findings**

1.4.1 **Introduction**

The following represents a summary of our findings, and represents only the key issues arising from our review. As such this section should be read in conjunction with the Report as a whole.

1.4.2 **Regulatory authority**

In our view the BMA is a well-run regulator with a strong commitment to achieving international standards. In general we consider the current regulatory structure, particularly following the introduction of legislation to regulate securities/investment business, to be in accordance with international standards. In particular we consider the BMA to be operationally independent in all areas except in respect of trust service providers where outdated legislation (which is to be amended) places formal licensing powers in the hands of the Minister of Finance. There are, however, some issues that still need to be addressed and these are discussed below.

We consider that current staffing levels are likely to need to be increased in line with the additional workload, particularly in relation to the introduction of the Investment Business Act.

We also consider that the BMA's oversight of the BSX should be extended.

Whilst the regulation of insurance also appears to be operated in a generally prudent manner, we do not consider the current structure to be in line with good practice. This is because the current position by which the Registrar is part of the Ministry of Finance means that the regulator is not operationally independent.

We therefore recommend that the section responsible in the Companies Registry for insurance should become an independent regulatory body and that the current powers exercised by the Minister of Finance are transferred to that new body.

1.4.3 **Banking**

Bermuda operates a regulatory regime that complies with all significant elements of the Basel Core Principles. This compliance was enhanced by the new Banking and Deposit Company Act ("BDCA") which provides a modern regulatory framework.

There are some areas where enhancements are still necessary but the BMA have identified these and are taking steps to achieve these enhancements. These enhancements involve the extension of on-site reviews and the provision of additional information in periodic returns from licence holders. These issues have continued to be addressed both before and since our visit to Bermuda.

1.4.4 **Insurance**

Whilst Bermuda has an acceptable legislative basis for the regulation of insurance companies, there are a number of areas that should be addressed. The most important of these is in respect of the current reliance by the regulator on third parties such as auditors.

Whilst such reliance is permitted under international standards, we consider that third parties should be subject to specific guidance and verification. In our opinion, this should involve at least some element of on-site inspection by the regulator. We do not consider that this is currently occurring to the extent necessary.

1.4.5 **Securities/investments**

The introduction of a regulatory regime for investments and securities is positive evidence of Bermuda's commitment to achieve full compliance with international standards.

The BMA accepts that the current legislation of securities/investment business in Bermuda does not fully comply with the international standards set out by IOSCO. Regulatory codes are in place and the elements of the on and off-site regulatory regime have been made clear to all licence holders and are currently being implemented following the award of licences during June and July 2000. The principal area which needs addressing is an increase in the enforcement powers of the BMA.

We also consider that the exemptions granted under the Investment Business Act are too wide and should be reduced.

1.4.6 **Collective investment schemes**

Bermuda has in place many necessary components for a well-regulated collective investment scheme sector. There are, however, a number of enhancements which need to be made. These particularly relate to the regulation and supervision of standard schemes. This is of importance as standard schemes make up the majority of collective investment schemes in Bermuda.

These improvements primarily relate to:

- the enhancement of off-site monitoring;
- legislative amendment to allow the introduction of on-site inspection for standard and institutional schemes;
- the inclusion of limited partnerships acting as a collective investment scheme within the regulatory scope;
- the introduction of further regulation for standard schemes; and
- further enforcement powers for the BMA.

We are aware that the BMA is looking to address a number of these weaknesses and we welcome this.

1.4.7 **Stock Exchange**

The BSX is operating broadly in line with international standards. There is however a need to introduce on-site inspection visits.

1.4.8 **Companies**

The Bermuda system of notification and vetting of proposed beneficial ownership puts it at a high level of compliance with good practice in this area, as it substantially exceeds the minimum requirement that the beneficial owner of a company can be identified.

Furthermore, in a wide range of other areas relating to companies, Bermuda meets the requirements of good practice. Nevertheless, as is the case in any system, some enhancements are still necessary, and our principal recommendations in this area are:

- the introduction of a capability to disqualify a person from acting as director of a Bermudian company;
- that the details of directors are submitted to the BMA and are subject to the same vetting process as beneficial owners; and
- that the names of directors should form part of the publicly available information held at the companies registry.

1.4.9 **Company service providers**

Bermuda operates a very conservative policy in respect of company formation. This is evidenced both by the requirement to notify the BMA of the proposed beneficial owners of companies and by the restriction on those who can prepare memoranda of association for remuneration to lawyers and accountants.

In general we consider Bermuda's approach to this area to represent good practice, ahead of many onshore and offshore centres.

Nevertheless, we consider that there are certain minor weaknesses in the Bermuda model which need to be addressed in order for the system to be fully robust against abuse. In particular, if Bermuda chooses not to introduce legislation covering those who are engaged in company service provision, the professionals who are permitted to undertake this activity must be

subject to an enforceable code of practice. They should also be subject to the anti-money laundering regulations in respect of this activity.

1.4.10 **Partnerships**

We are of the view that, with some minor exceptions, the legislation and systems in place in Bermuda concerning limited partnerships meet good practice.

Our principal recommendations to overcome these weaknesses are:

- that where the accounting records of a limited partnership are not kept at its registered office, the registered office should maintain a written record of where they are kept; and
- that the Registrar of Companies (who is also responsible for the registration of limited partnerships) should have enforcement powers to:

  (1) apply to the courts for the dissolution of a partnership on public interest grounds or on grounds of fraud or insolvency; and

  (2) apply to the courts for the appointment of an inspector to investigate the activities of a limited partnership.

1.4.11 **Trusts**

Trust legislation in Bermuda is similar to the trust legislation in a number of other jurisdictions. In general, we do not consider that there are any features of the Trustee Act that are likely to lead to trust structures in Bermuda being considered particularly attractive to those wishing to engage in criminal conduct.

As a general point, rather than one specific to Bermuda, we recommend that legislation is amended to prevent the use of so-called "flee" clauses in trust documents to frustrate legitimate creditors or to prevent regulatory or criminal investigation.

1.4.12 **Trust service providers**

Whilst the existence of legislation relating to trust service provision is a further positive feature of Bermuda's regulatory regime and addresses many areas of good practice, we agree with the BMA that the current legislation regarding trust service providers is in need of enhancement and welcome the fact that it is working on proposals for new legislation which will fully comply with standards of good practice.

As part of this legislative update there is a need to address the joint responsibility for licensing and regulation which currently exists. Furthermore, attention needs to be paid to the establishment of a more robust application procedure.

Whilst trust service providers are required to comply with rules for "know your client" as set down in the anti-money laundering guidance notes, there is a need to adopt a more general code about practices to be adopted together with the capability to enforce such a code and the ability of the BMA to access client files where appropriate.

1.4.13 **International co-operation**

Bermuda has a strong legislative base for international co-operation. There is, however, a need for a number of specific improvements. The most important of these is an increase in regulatory ability to assist foreign regulators in investigations of Bermuda persons or entities.

1.4.14 **Anti-money laundering**

Bermuda has a significant level of anti-money laundering provisions in place. The legislation, regulation and the Guidance Notes taken together are comprehensive and contain most of the material and cover most of the issues that we would expect to find in a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of Bermuda's commitment to the prevention of money laundering.

There are a few other areas where we consider that enhancements are required if Bermuda is to fully comply with international standards. The principal enhancements required are:

- the scope of those covered by the anti-money laundering regulations needs to be extended; and

- the legislation needs to be slightly amended to ensure full international co-operation with other law enforcement bodies can be provided.

1.5 **Conclusion**

Overall, the BMA ranks as one of the most developed offshore regulators, meeting or exceeding many international standards and making considerable progress to meet those it is not yet in full compliance with. Similarly the controls in place in Bermuda, particularly in relation to the formation of companies are, in our view, a major deterrent to the criminal abuse of Bermudian companies.

The key areas to be addressed relate to the further development of the capability to assist overseas regulators in the conduct of investigations and providing operational regulatory independence and limited enhanced supervision in respect of the insurance sector. The enhancement of regulation of trust service provision also needs to be addressed and we welcome Bermuda's commitment to dealing with this.

We welcome your comments on this site. *Prepared 27 October 2000*

2 Methodology

2.1 Introduction

2.1.1 The UK Government White Paper

The UK Government White Paper "Partnership for Progress and Prosperity: Britain and the Overseas Territories" ("the White Paper")[1] was presented to the UK Parliament in March 1999.

The White Paper recognised that the international financial service industry has grown dramatically in recent decades and that a significant number of the Overseas Territories have developed successful offshore financial sectors and so diversified their economies. The White Paper further commented that it was essential for the future of the financial services sector that the Overseas Territories reputation for honest administration and probity be preserved and enhanced.

The White Paper stated that development of sizeable financial sectors brings risk of abuse and that as markets develop and techniques for laundering money, fraud, tax evasion and regulatory abuse evolve so financial regulatory systems must improve, be updated and be responsive to ever tighter international standards.

The White Paper further stated that the Caribbean Overseas Territories in particular are a potential target for money launderers because of their offshore financial business, their proximity to major drug producing and consuming countries and, in some cases, their inadequate standard of regulation and strict confidentiality rules. The White Paper also stated that the Territories are also at risk from attempted fraud and that failure to tighten regulation could affect the stability of and confidence in financial markets. The White Paper emphasised the importance of the Overseas Territories meeting accepted international standards. To assess progress made in this area, it required an in-depth independent review to be undertaken by regulatory experts. This review was also to make recommendations as to how to deal with any issues outstanding.

2.1.2 Development of the review process

Following the publication of the White Paper, a Steering Committee was formed. This Committee comprised representatives of the Foreign and Commonwealth Office ("FCO"), the Treasury, the Financial Services Authority and the Governments of the Overseas Territories.

The Steering Committee approved the Terms of Reference ("TOR") for this review, together with Guidance Notes on international standards and good practice relating to the areas under review. We understand that the guidance on accepted international standards in financial regulation ("the Guidance Notes") contained within the TOR was arrived at following a process of detailed consultation and discussion between representatives of the Overseas Territories, the FCO, HM Treasury and the UK Financial Services Authority. These are attached in Appendix 1.

The Guidance Notes represent good practice. The Overseas Territories have therefore chosen to be assessed against standards which, in a number of areas (such as company and trust service provision), are not applied in a number of major centres. This approach demonstrates the commitment of the Overseas Territories in seeking to ensure that financial regulation in these jurisdictions will eventually meet high standards. As such they are providing a powerful role model to other offshore centres.

The Guidance Notes do not prescribe how particular standards should be achieved; rather, the Overseas Territories are left to decide for themselves how best to achieve the standards laid down in them.

On 20 December 1999 we were appointed by the FCO, acting on behalf of the Steering Committee, to undertake the review of financial regulation referred to above.

The review covers Anguilla, Bermuda, the British Virgin Islands ("BVI"), the Cayman Islands, Montserrat and the Turks & Caicos Islands ("TCI") (referred to collectively as the Overseas Territories). The White Paper covers a wider number of locations (such as Gibraltar) but this review is restricted to these six Overseas Territories.

The purpose of the review has been to assess the Overseas Territories' performance against international standards and good practice, and to make recommendations for improvement where any territory falls below those standards.

2.2 **Scope of the review**

The scope of the review was as follows:

In relation to the regulation of financial services activity

- List separately the type and composition of offshore financial services business in each Overseas Territory.
- Ascertain what legislation, regulations, rules, guidance, systems and procedures (statutory or otherwise) govern the regulation and supervision of the:

  - Banking sector

  - Insurance sector

  - Securities sector (including mutual funds and stock exchanges).

- Assess the monitoring, supervision and regulation of activity as well as the enforcement of rules, regulations and laws.
- Evaluate to what extent arrangements in the Overseas Territories meet the standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).
- Consider the adequacy of the system of supervision relative to the objectives of Overseas Territories' financial services regulation.
- Comment on the existence and adequacy of depositor and investor protection schemes.
- Determine whether further action is required by any territory in order to meet the standards set out in the Guidance Notes and prioritise recommendations.

In relation to the regulation of companies, partnerships and trusts

- Ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts.
- Detail the type of information available on the activities of companies, partnerships and trusts.
- Determine whether the regulatory mechanisms in place are sufficient to meet international standards.
- Consider whether further action is required by any Overseas Territory to meet the standards required and prioritise recommendations.

In respect of independent regulatory authorities

- Evaluate to what extent regulatory authorities comply with accepted international standards advocated principally by Basel, IOSCO, the Offshore Group of Banking Supervisors (OGBS) and IAIS.
- In particular, evaluate whether regulatory authorities are accountable, independent and free from business and political influence and properly staffed and budgeted for with an independent source of income.
- Determine whether the relevant authority is detached from the marketing of financial services and, where this is not so, assess any impact this may have on the ability of the regulatory authority to regulate the sector objectively.
- Assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; co-operate with requests for assistance from foreign authorities; enforce rules, regulations and laws by taking enforcement action; and the extent to which they can liaise with law enforcement authorities in the sharing of information.
- Consider which activities fall under the responsibility of the regulatory authority and whether the regulatory net covers all financial activities.

- Consider what legal advice is available to the authority and its effectiveness in helping the Overseas Territory's government to regulate the sectors.

In relation to international co-operation

- Evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of the Overseas Territory's law enforcement and regulatory authorities to co-operate with requests for assistance from foreign authorities.
- Ascertain what legal advice is available to regulatory and law enforcement authorities in the Overseas Territory, and determine effectiveness in helping the Overseas Territory's government to co-operate in these areas.
- Determine whether further action is required by any territory in any of these areas, and the relative priority of such action.
- Consider whether there are effective "gateways" provisions in place concerning co-operation between regulatory authorities as well as the Overseas Territory's powers to obtain information, including by compulsion, the ability of foreign authorities to take voluntary testimony from the Overseas Territory's residents and the Overseas Territory's ability to safeguard the confidentiality of information provided by foreign counterparts. In addition, determine whether there are any provisions governing conditions under which information may be passed to overseas jurisdictions and whether effective memoranda of understanding exist (where required to underpin co-operation).
- Assess the extent to which the Overseas Territory's law enforcement authorities can obtain evidence on behalf of their foreign counterparts and exercise other available mutual legal assistance powers, stating the mechanisms and the Overseas Territory's authorities involved.
- Assess the Overseas Territory's ability to assist foreign authorities in tracing, freezing and confiscating proceeds even if the underlying conduct takes place outside the Overseas Territory.
- Assess the effectiveness of mutual legal assistance treaties with the USA where applicable and provide the basic volume of requests for assistance made and received.
- Assess powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted.
- Assess the ability to safeguard the confidentiality of information provided to Overseas Territory's law enforcement authorities.
- Assess whether effective memoranda of understanding exist, where required, to underpin co-operation.
- Evaluate whether there is effective co-operation between law enforcement authorities and financial regulators both domestically and abroad.
- Consider the ability of the Overseas Territories' regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

In relation to measures to combat money laundering

- Establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the Overseas Territories to combat money laundering and types of offences caught by the legislation.
- Determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.
- Evaluate the effectiveness and adequacy of those arrangements in terms of how they meet the applicable international standards.
- Provide specific consideration to the offences considered predicate for the purposes of money laundering legislation.

- Consider whether the Overseas Territories' have regulatory legislation in addition to the principal money laundering offences and, if not, whether guidelines and/or codes of practice exist (statutory or otherwise).
- Consider the Overseas Territories' systems for reporting suspicious transactions and identifying customers, the institutions obliged to report, how reports are dealt with and within what timeframe.
- Consider how this information is disseminated and shared with foreign counterparts.
- Evaluate the ability of financial intelligence units or their equivalent to deal with suspicious transactions.
- Determine to what extent the Attorney-General's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws.

2.3 **Project governance**

2.3.1 **The Steering Committee**

The Steering Committee played a key role in setting the parameters for and guiding the conduct of the review by its involvement in:

- agreeing the TOR and benchmark standards to be applied by the review team prior to its appointment;
- offering guidance over the detailed review process through a series of Steering Committee meetings which took place at key stages in the review process; and
- agreeing the format and reviewing the content of this report and providing comment as appropriate.

The responsibility for the opinions expressed, is however, a matter for KPMG.

2.3.2 **The Strategic Team**

In undertaking the review, KPMG utilised a Strategic Team composed of former senior regulators from a number of different jurisdictions, as well as its own partners and staff. The involvement of these individuals enabled the assessment better to take into account how the standards are implemented in practice on an international basis.

Members of the Strategic Team have had significant involvement in the setting of international standards as well as their implementation. The team included a former Chairman of IOSCO's Technical Committee, the Director of Regulation at Lloyd's of London, a former Deputy Director of the United States Securities and Exchange Commission of International Affairs, a former executive Director of the Hong Kong Securities and Futures Commission and the former Chief Executive of the Isle of Man Financial Supervision Commission.

The external members of the Strategic Team provided advice and guidance to KPMG, particularly during the early stages of the project and through the initial drafting of this report. The role of the external members of the Strategic Team was advisory, however, and the analysis and recommendations in this report are the responsibility of KPMG.

2.3.3 **Responsibility for this report**

This report has been prepared by the UK firm of KPMG. Although we have associated firms in the Overseas Territories, they have not been involved in the preparation of this report, nor should any responsibility for any of the opinions in this report be attributed to them.

2.4 **Approach to the review**

2.4.1 **Structure of the report**

The individual sections of the report are generally divided into a number of parts, as follows:

- an introduction, giving a broad outline of the international standards and/or good practice against which our assessment is made;
- a description of the nature and scale of the activity in the jurisdiction;

- a factual assessment produced in conjunction with the Overseas Territory which has been formally confirmed by them as accurate; and
- a section covering the issues arising from our analysis, together with recommendations we consider appropriate to remedy any deficiencies identified.

2.4.2 **Benchmarks**

In determining the appropriate international standards and good practice we have, as instructed in the TOR, used the Guidance Notes.

In the areas of banking, insurance, securities/investments and stock exchanges there are established international standards by which compliance can be assessed. Similarly, with respect to anti-money laundering measures, the recommendations of the Financial Action Task Force and the Caribbean Financial Action Task Force provide benchmarks.

However, in other areas, such as the provision of company and trust services, there are no internationally accepted standards. The Guidance Notes have instead been based upon what has been agreed as good practice.

In accordance with the TOR we have, in conducting this review, taken due notice of the recommendations made in the recent Home Office report on the Review of Financial Regulations in the Crown Dependencies. However, the terms of reference for the two reviews are substantially different in that benchmark standards were not defined in the Home Office review and hence there was no requirement to make an assessment against them.

Accordingly, in framing our recommendations we have assessed compliance with the benchmark standards set out in the TOR.

2.4.3 **Phases of the review**

2.4.3.1 ***Legislative review***

At the outset of the review the Overseas Territories provided us with copies of relevant legislation and regulations.

2.4.3.2 ***Pre-visit questionnaires***

Prior to commencing our on-site reviews, we prepared a pre-visit questionnaire for completion by each of the Overseas Territories. The questionnaire covered the areas required by the TOR. A draft questionnaire was reviewed by the Steering Committee and their comments were incorporated prior to issue. Comments were also invited and received from other parties with experience in relevant areas, for example the FATF in respect of money laundering.

Following this consultation the questionnaire was issued and responses received from the Overseas Territories. These responses were analysed by us prior to the commencement of the on-site review.

2.4.3.3 ***On-site review programme***

The analysis of questionnaire responses was used to prepare a work programme for the on-site review. This mechanism was important in ensuring that the on-site stage of the work was completed to a consistent standard across all the Overseas Territories.

2.4.3.4 ***On-site review***

The on-site review was undertaken in March and April 2000. It comprised in excess of twenty-six man weeks in the Overseas Territories. A total of eight staff, together with two members of the Strategic Team, were deployed across the Overseas Territories. Each consultant was allocated a specific area for review in line with their sector specialism. Work was conducted in line with the on-site review programmes outlined above, adjusted where necessary for issues identified on-site.

2.4.3.5 ***Meetings with third parties***

As part of the review process we had extensive discussions and meetings with third parties (in the UK, the Overseas Territories and elsewhere) who had experience of, or an interest in, the jurisdictions under review. These third party discussions were particularly pertinent in the areas of international co-operation and anti-money laundering measures.

Meetings with the third parties referred to above included:

- The United States Securities and Exchange Commission ("SEC");
- The United States Department of Justice ("DoJ");
- Representatives of the Overseas Territories;
- The United States Federal Reserve;
- The White Collar Criminal Investigation Team ("WCCIT");
- The Overseas Territories Regional Criminal Intelligence System ("OTRCIS");
- The Financial Services Authority ("FSA");
- The National Criminal Intelligence Service ("NCIS"); and
- The Ontario Securities Commission ("OSC").

2.4.3.6 ***Findings from previous reviews***

Our review also considered the results of previous reviews of sectors of the various Overseas Territories. These included:

- the 1992/3 Bank of England "Report on the arrangements for the supervision of offshore banks", covering Anguilla, the BVI, Montserrat and the TCI;
- the CFATF mutual evaluation of Bermuda, the BVI, the Cayman Islands and the TCI; and
- the 1993 Sullivan Reports on the regulation of insurance in Anguilla, the BVI, the Cayman Islands, Montserrat and the TCI.

In addition to the above, we have used other information sources including promotional and advisory material issued by the Overseas Territories and others.

2.4.3.7 ***Reporting***

Whilst we have sought to give due credit for regulatory achievement wherever possible, it should be noted that our reports are phrased on an exceptions basis. We have identified issues and made recommendations in those areas where we consider they are required. The nature of our issues and recommendations tend to reflect the stage of regulatory development reached by the jurisdiction in question.

Those jurisdictions with more mature financial sectors and better developed regulation have tended to generate more detailed recommendations.

In those jurisdictions where we have identified a more significant lack of basic regulatory structures, our recommendations are, necessarily, focused on the major issues to be addressed. There will inevitably be many subsidiary issues which will need to be considered following action on those which are more fundamental. It is impossible to anticipate these until those more significant issues have been addressed.

2.4.3.8 ***Confirmation of factual accuracy and discussion of findings***

Following the on-site reviews, we issued initial draft reports in May 2000. We then visited each of the Overseas Territories over a two-week period at the end of May.

This second visit was designed to give the Overseas Territories the opportunity to comment on findings and confirm the factual accuracy of the initial draft reports. Comments received during the course of this visit were confirmed (where they related to issues of factual accuracy) and considered. Our draft reports were adjusted where the review team considered this to be appropriate.

Following these second on-site visits, further draft reports were prepared. These were issued on 17 July. They were also discussed with the Overseas Territories who (along with the Steering Committee) were again given an opportunity to comment. Written as well as oral comments were received from the Overseas Territories and others; all have been carefully considered.

The Overseas Territories have provided formal written confirmation of the factual accuracy of the relevant parts of our reports.

2.4.4 **Regulatory arbitrage**

Regulatory arbitrage is the selection of a jurisdiction of operation on the basis of the regulatory legislation and structure in place. Regulatory arbitrage tends to result in persons who, for their own reasons, wish to avoid regulation selecting less regulated jurisdictions. Consequently, less regulated jurisdictions often become a target for money launderers and fraudsters.

All the jurisdictions have expressed a commitment to achieve the required international standards in financial services regulation envisaged by the White Paper. We consider that it should be recognised that other offshore centres, not being part of the Caribbean Overseas Territories and Bermuda, who also provide financial services and who may be regarded as competitors of the Overseas Territories, may not share the same level of commitment.

To prevent the possibility of regulatory arbitrage, even on a short term basis, the adoption of international standards should be seen as a global issue and not simply one of relevance to the Overseas Territories. Therefore, other jurisdictions should be encouraged to ensure that they introduce similar improvements and thereby facilitate a level playing field between jurisdictions.

The work of groups such as the Financial Stability Forum in raising global standards will be of importance in this area and should continue to receive strong support from both the UK and the Overseas Territories.

2.4.5 **Scope limitations and other related matters**

Our terms of reference do not provide for us to verify all the factual matters in this report, which would be a major and time consuming task. Instead, as agreed with the Steering Committee and set out in the TOR, we asked the Overseas Territories to provide us with information (including copies of relevant legislation) and to check various drafts of our reports for factual accuracy. This they have done. It should be appreciated that any further information not provided to us might alter our conclusions.

In a number of instances, sector information (for example total funds under management and analyses of a jurisdiction's main sources of business) is not collated by the jurisdiction and therefore was not available to us. In other cases available information is dated.

There was also, on occasion, a lack of available statistical information, particularly in relation to co-operation provided by the Overseas Territories to other jurisdictions. It appears that either this information is not available in a format that is retrievable to provide the statistics necessary, or it is not kept at all. The absence of such information has made certain comments on the level of co-operation provided by the Overseas Territories impossible to verify or refute. Recommendations to resolve this matter have been made in the report.

This report has been prepared for the sole purposes of a review of Financial Regulation in the Caribbean Overseas Territories and Bermuda for the Steering Committee comprising representations from the Foreign and Commonwealth Office, HM Treasury, Financial Services Authority and Governments of Bermuda, Cayman Islands and Anguilla ("the client"). It has been designed to meet the agreed requirement of the client and particular features of the engagement of KPMG determined by the client's needs at the time. This report should not therefore be regarded as suitable to be used or relied on by any person or organisation other than the client or for any other purpose or in any other context. Any person or organisation other than the client who chooses to rely on this report will do so at its own risk. KPMG will accept no responsibility or liability in respect of this report to any third party.

2.4.6 **Timescale**

Whilst we have noted areas where we consider action is required as a priority we have not set out specific timescales. We consider that the precise timescales are best determined bilaterally between the individual Overseas Territories and the Foreign and Commonwealth Office.

2.4.7 **Acknowledgements**

We are most grateful for the significant amount of time spent by representatives of the Overseas Territories, Her Majesty's Government and the other organisations whom we met.

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We welcome your comments on this site. *Prepared 27 October 2000*

3 Regulatory authority

3.1 Introduction

As stated in the White Paper, a sound, transparent regulatory environment is necessary to maintain investor confidence and the reputation of the financial sector in a particular jurisdiction. This is only possible if the regulatory authority is, and is seen to be, independent.

In order to demonstrate this 'independence', the jurisdiction must be seen to meet international standards. These standards extend beyond simple independence to encompass such issues as resourcing and accountability. This theme is developed further below.

Our terms of reference cite four documents which provide specific details on what the international community expects from a regulatory authority. These documents are:

- Objectives and Principles of Securities Regulation issued by the International Organisation of Securities Commissions ("IOSCO");
- Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision ("Basel");
- The Supervision of Cross-Border Banking by Basel and the Offshore Group of Banking Supervisors ("OGBS"); and
- Insurance Principles, Standards and Guidance Papers by the International Association of Insurance Supervisors ("IAIS").

These documents consider all aspects regarding the regulatory authority including licensing, supervisory and enforcement powers and the ability of the authority to co-operate with other regulatory and legal bodies.

In addition, the Guidance Notes introduce several concepts which are not explicitly referred to in the documents above but which are included in the scope of our review.

International co-operation and the powers of the regulator pertaining to the different financial sectors in the jurisdiction are dealt with elsewhere in this report.

This section deals solely with the consideration of the remaining principles relating to the regulator. The Supervision of Cross-Border Banking and the Insurance Principles, Standards and Guidance papers do not refer to this subject and, as such, their content has been excluded from this discussion.

3.2 Principles relating to a regulator

The following section sets out the criteria underpinning what constitutes a regulatory authority which is deemed to meet acceptable international standards and the implications for the jurisdictions under review.

The source of the information set out in this section is Basel principle 1, IOSCO principles 1 to 5 and the Guidance Notes.

The regulatory authority should have clearly defined responsibilities, be operationally independent and accountable, have adequate powers and resources, be consistent in its approach and observe the highest professional standards including upholding appropriate standards of confidentiality.

- Clear responsibilities

Ideally the responsibilities of the regulator should be set out in law and adequate legal protection should be provided to the regulatory authority and its staff. Legislation should be designed to avoid gaps or inequities in regulation.

- Independence and accountability

The regulator should be operationally independent from external political and commercial influence and be accountable in

the use of its powers and resources. Independence is deemed to be enhanced by a stable source of funding and would be considered to be compromised by any marketing activities carried out. Approval of decisions made by the regulator, by the government or a minister does not necessarily constitute a lack of demonstrable independence providing any such consultation does not include decision making on regulatory matters.

- Powers and resources

The regulator must have adequate powers and the capacity to exercise its powers, including licensing, supervision, inspection, investigation and enforcement. In many cases these powers vary across the financial sectors represented in the jurisdiction and therefore these are considered in the relevant sections of this report.

In order to exercise its tasks, the regulator must be adequately funded with the level of funding reflecting the difficulty of retaining experienced staff. Training should be provided as required on an ongoing basis.

- Clear and consistent processes

The processes adopted by the regulator should be comprehensible, transparent, fair and equitable and consistently applied. On policy decisions, the regulator is expected to consult with those who may be affected; it is generally desirable to make public disclosure of policy. The regulatory authority should also play an active role in the education of financial service industry participants.

- Staff conduct

Staff of the regulator are expected to observe the highest professional standards and be given clear guidance on conduct matters including on conflicts of interest, use of information obtained, fairness and the observance of confidentiality provisions.

3.3 Self-regulation

IOSCO principles 6 and 7 advocate the use of self-regulatory organisations ("SROs") in appropriate circumstances, providing the SROs are subject to the continuous oversight of the regulator and observe similar standards of conduct to the regulator itself.

3.4 Factual assessment

3.4.1 Introduction

In most areas, Bermuda demonstrates compliance with international standards. Information pertinent to our analysis is set out below, with recommendations for improvement where relevant.

3.4.2 Clear responsibilities

The primary regulator in the jurisdiction is the BMA. The BMA has a range of functions as central monetary authority in addition to its specific regulatory responsibilities. The constitution, responsibilities and powers of the body are set out in the Bermuda Monetary Authority Act 1969 (the "BMA Act"). Every person, body or entity specified in the Third Schedule, referred to in the BMA Act as a financial institution, is subject to supervision, regulation and inspection by the BMA. The financial institutions currently defined in the Third Schedule are as follows:

- The Bermuda Stock Exchange;
- Collective Investment Schemes;
- Credit Unions;
- Trust Companies (as defined in the Trust Companies Act 1991);
- any institution (within the meaning given in the Banks and Deposit Companies Act 1999);
- an investment provider licensed under the Investment Business Act 1998.

The BMA currently has five operating divisions which cover investment business, deposit taking institutions and trust companies, authorisation and compliance, policy, research and statistics and administration.

By virtue of section 8(4) of the Banks and Deposit Companies Act 1999 neither the Authority nor an officer or servant of the Authority shall be liable in damages for anything done or omitted in the discharge of the functions of the Authority under the BDCA unless it is shown that the act or omission was in bad faith. Similar protection is afforded by section 4(5A) of the BMA Act.

3.4.3 **Independence and accountability**

There is no evidence to suggest that there is any undue business influence over the regulatory activities of the BMA.

The BMA is accountable by virtue of the BMA Act to the Minister of Finance. An annual report on its operations including its audited financial statements is supplied to the Minister. This report is available to the public. Decisions of the BMA could be subject to judicial review; however, no cases have arisen to date concerning the actions of the BMA.

The BMA undertakes no marketing activity but does contribute articles, and occasionally speakers to provide information on the regulatory environment and approach.

3.4.4 **Powers and resources**

3.4.4.1 ***Introduction***

Those parts of the Guidance Notes which relate to powers and resources pertaining to international co-operation and the powers of the regulator in respect of the different financial sectors in the jurisdiction are dealt with in the sector specific sections of this report.

3.4.4.2 ***Staffing***

The BMA informed us at the time of our on-site work that its current complement was 37 people against a budgeted complement of 39, with one of the two remaining vacancies already filled and the appointee due to start shortly.

Among the current staff there are a number with professional qualifications including Chartered Financial Analyst, Master of Business Administration, Fellow of Chartered Institute of Bankers, Chartered Accountant and those holding an accounting and law degree, as well as those with broad supervisory and relevant experience.

3.4.4.3 ***Training***

The training needs of individual staff are reviewed regularly as part of their appraisal. The BMA provides support to individual members of staff in relation to certain of their professional requirements. Use is made of a wide range of external courses and seminars, organised by both regulators and commercial organisations.

3.4.4.4 ***Sources of income***

Funding of the BMA's activities is independent from Government as its income is primarily derived from investment income earned on the portfolio of assets which forms the backing to Bermuda's currency issue. The Government has accepted the principle that the cost of regulation should be recovered from the industry and a first step in implementing that approach has been introduced under the new BDCA.

3.4.4.5 ***Licensing powers***

Licensing powers are not consistent across the various financial services sectors prevalent in the jurisdiction. In relation to banks and deposit companies, the Minister of Finance has a power of veto on licence applications where he concludes that the grant of a licence would not be in accordance with the economic and monetary policies of the government. For collective investment schemes and investment business, the BMA has the sole responsibility for the granting of licences.

3.4.5 **Clear and consistent processes**

3.4.5.1 ***Consultation***

Informal consultation takes place with the industry groups and other interested parties. Standard arrangements exist for consulting the industry on changes of policy.

The BMA is required under the Investment Business Act to consult the Minister of Finance prior to issuing codes of conduct, however the final decision over content rests with the BMA. Less formal rules and guidance are entirely a matter for the

BMA.

3.4.5.2 ***Involvement in legislative development***

The BMA has regular dialogue with the Ministry of Finance regarding the scope and content of existing legislation as well as potential new legislation. The BMA regularly consults with industry groups and other interested parties and has standard arrangements for consulting the industry on proposed changes of policy.

3.4.5.3 ***Documented procedures***

The BMA does not currently have a procedures manual for all key elements of its work namely licensing, off-site review and on-site review. We understand that the BMA is engaged in drafting procedures area by area in relation to its new responsibilities under the Investment Business Act.

3.4.5.4 ***Disaster recovery plan***

A disaster recovery plan exists but is out of date in the opinion of the BMA's senior managers and needs to be updated. Some backup banking records are maintained both off and on-site as protection.

3.5 Issues and recommendations

3.5.1 Introduction

In our view the BMA is a well-run regulator with a strong commitment to achieving international standards. In general, we consider the current regulatory structure to be in accordance with international standards. In particular, we consider the BMA to be operationally independent and to be deploying properly trained/experienced resource.

3.5.2 Independence

We consider that there is a need for the BMA to assume full regulatory authority over trust service providers. Currently some responsibility lies with the Minister of Finance. This is detailed in the trust service provider Section 13.

3.5.3 Staffing

The size of the individual divisional teams coupled with potentially unpredictable demands of the work load and the time taken to fill vacancies can lead to short-term problems.

The requirements of the Investment Business Act in respect of initial licensing and on-going monitoring will put a further strain on the regulator's resources and we consider that staffing requirements are likely to increase. The BMA must, therefore, continue with its policy to fill the staff vacancies and retain existing staff, whilst undertaking an assessment of the additional resources required in the new area.

3.5.4 Disaster Recovery plan

We agree with the BMA that the disaster recovery plan needs updating.

3.6 Oversight of the Bermuda Stock Exchange

3.6.1 Factual assessment

The BSX is a self-regulatory organisation ("SRO") which is subject to oversight by the BMA. The monitoring of BSX activities includes periodic meetings, the receipt of financial information regarding the exchange itself and vetting procedures carried out in respect of new membership applications. The BMA has the capability to monitor exchange trading through a trading screen with supervisory access. We did not see any evidence of checking being carried out by the BMA in respect of the vetting process used by BSX on its listing applications.

3.6.2 Issues and recommendations

Whilst the level of activity on the BSX suggests that significant oversight of the BSX by the BMA is not required, it is questionable whether the BMA can demonstrate effective supervision of its SRO.

The oversight of the BSX by the BMA should be subject to a formal policy document on how the BMA oversees the BSX which also addresses the duplication of vetting procedures outlined in Section 8 of this report. A formal, documented

supervisory process also needs to be initiated.

3.7 Registrar of Companies

3.7.1 Factual assessment

Regulation of insurance business is conducted by the Registrar of Companies. The Registrar is directly accountable to the Minister of Finance.

3.7.1.1 *Staffing*

The Registrar of Companies has advised us that its current staff complement is 37. Among the current staff there are a number with professional qualifications including Certified Public Accountants, Master of Business Administration, and individuals who shall shortly be writing their final exam for a professional accounting designation.

In addition there are staff with broad insurance, auditing, banking, compliance and supervisory experience. Technical Officers require a minimum of a Bachelor's degree and two years experience in a business-related discipline. All senior managers are required to have advanced degrees and/or professional designations and a minimum of between five and ten years management experience.

3.7.1.2 *Training*

The department maintains membership in and attends as many of the quarterly meetings as possible of the NAIC, the IAIS and other regulatory bodies in order to keep current with emerging issues. In addition, the department participates in seminars and training provided by the Bermuda Insurance Institute on a regular basis. Further, members of the department attend insurance conferences such as RIMS, the World Captive Forum and ASHRMS and other similar conferences where current topics are discussed.

The Registry has utilised programmes such as the CPA, CPCU, ACII to facilitate, additional training. The Registry has also looked for training opportunities within the private sector, such as in-house technical training seminars and workshops relating to accounting and insurance.

3.7.2 Issues and recommendations

3.7.2.1 *Reliance on the work of third parties*

In exercising his supervisory powers the Registrar of Companies places reliance on:

- the BMA for vetting shareholders of proposed companies;
- the Insurers Admissions Committee who, together with the Registrar, review and make a recommendation regarding the approval of applications for the incorporation and licensing of insurance entities; and
- the auditors, who conduct an annual independent statutory audit of all insurers.

This indicates that regulation is reliant on the work of third parties particularly in the context of on-site supervision.

Whilst IAIS principles and standards do not preclude the use of external agents from carrying out on-site elements of supervision, we consider that where such an approach to supervision is adopted, certain verification and guidance procedures must be introduced by the regulator.

Auditors in Bermuda currently provide a statutory audit opinion in accordance with the Insurance Act, an opinion on an insurer's solvency certificate and on the necessary declaration of statutory ratios. The non-statutory opinions are given in accordance with the Insurance Returns and Solvency Regulations 1980.

The Registrar accepts that an auditor's report does not in itself replace the need for an on-site inspection, however the view is taken by the Regulator that the processes undertaken to produce such a report do fulfil this function.

It is also the view of the Registrar that the outsourcing of annual inspections to independent agents rather than conducting this work in-house improves the efficiency and effectiveness of the process in a market such as Bermuda, where the predominant proportion of the industry is captive business and the public is not in any way exposed to potential harm. Whilst we do see merit in the efficiency argument, in our view such delegation can only be effective if certain criteria are met:

- there should be specific guidance notes in issue which include the prescribed format of regulatory reports;
- active dialogue between the regulator and independent agents must occur throughout the process including the definition of scope and initial direction and the discussion of the agent's findings; and
- the regulator must conduct checks of its own to ensure that the agents are fulfilling their responsibilities.

At present, reporting by the auditor is restricted to financial matters prescribed by the Insurance Act and its related regulations. To the extent required, we believe this arrangement satisfies the first two criteria, but not the third.

However, we believe that the scope of on-site inspections should extend beyond purely financial issues and should encompass other aspects of insurance business such as investment policy, underwriting policy and proper record keeping.

Therefore in our opinion:

- there are aspects of on-site supervision which are not being performed by any of the various parties involved with insurance regulation; and
- where reliance is currently being placed on third parties, there is no vetting of their "field work" following the conduct of the statutory audit.

We recommend that, in order to achieve effective delegated, full-scope on-site supervision, the Registrar should issue guidance notes covering non-financial aspects of supervision, procedures and reporting, participate in a more active dialogue with its agents through the process and carry out periodic vetting checks at its insurance licence holders to ensure these agents are adequately fulfilling their role.

3.7.2.2 ***Operational independence***

The relationship with the Minister of Finance does not accord with the principle of regulatory independence.

In order to meet good practice as set out in the Guidance Notes, we believe the insurance element of the companies registry should be separated into a body with statutory independence which would take on full responsibility, amongst other things, for licensing, supervision and enforcement. The powers currently vesting with the Minister of Finance should be transferred to this new body.

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4 Banking

4.1 Introduction

There are established international standards in place concerning the regulation and supervision of banking. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of banking conform to the standards outlined in the "Core Principles for Effective Banking Supervision" (the "Core Principles") produced by the Basel Committee on Banking Supervision ("Basel Committee"), together with the report by members of the Basel Committee and members of the Offshore Group of Banking Supervisors on the "Supervision of Cross-Border Banking".

The Core Principles comprise 25 basic principles required to be in place for a supervisory system to be effective. The Principles cover:

- preconditions for effective banking supervision (Principle 1);
- licensing and structure (Principles 2 to 5);
- prudential regulations and requirements (Principles 6 to 15);
- methods of ongoing banking supervision (Principles 16 to 20);
- information requirements (Principle 21);
- formal powers of supervisors (Principle 22); and
- cross-border banking (Principles 23 to 25).

The requirements relating to cross-border banking were developed by the report "Supervision of Cross-Border Banking". This detailed the requirements for effective home and host banking supervision in order to facilitate effective consolidated supervision including the associated necessary information flows between regulators.

Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against the above standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

4.2 Type and scale of banking activity

The BMA currently regulates three licensed banks in Bermuda. Of these, two provide a full range of retail, commercial and private banking services, including international money transfer, cash management, treasury services, global investment, custody and brokerage services, corporate finance and trade finance. Both institutions have an extensive network of subsidiaries and offices domestically and internationally.

The third institution is primarily engaged in corporate and private banking and investment services and wholesale market placement of funds.

In addition, the BMA also regulates four deposit companies which provide retail financial facilities to the local market, primarily mortgage facilities for the acquisition of residential property and fixed term deposit accounts in Bermuda dollars. They may also now provide a range of foreign currency services to their clients following recent authorisation from the BMA.

Data provided by the BMA for the three banks and four deposit companies shows that, as of 31 March 2000, the total assets were US$ 16.7 billion and total capital US$ 996 million (of which Tier 1 capital is US$ 900 million).

4.3 Factual assessment

4.3.1 **Legislation**

The legislation relevant to banking and its regulation in Bermuda is as follows:

- The Bank and Deposit Companies Act 1999 ("BDCA");
- The Bermuda Monetary Authority Act 1969 ("BMA Act").

The BDCA has been recently introduced to modernise the previous legislation. Like the BMA Act it governs banking regulation and assigns supervisory responsibility to the BMA.

Under the BDCA it is an offence to undertake deposit taking business in or from within Bermuda without a licence. The only exemptions to this are the Government of Bermuda, public authorities in Bermuda and the BMA itself.

Responsibility for prudential decisions and judgements lies with the BMA. The Minister of Finance may give the BMA general policy directions in relation to its functions under the BDCA, but cannot otherwise interfere with the BMA's discretionary powers. No general policy directions have been issued to date.

The BDCA covers areas such as:

- application procedures;
- powers and duties of the BMA;
- powers of the Minister of Finance;
- powers of entry in case of suspected contraventions; and
- immunity for the BMA in the exercise of its powers.

4.3.2 **Regulations**

The BDCA received assent on 23 September 1999. Subsidiary regulation issued covers the following areas:

- the minimum loan percentage for deposit companies;
- exemption of credit unions; and
- the meaning of deposits and deposit taking business.

4.3.3 **Guidance notes**

A number of guidance notes on key subjects have been issued over the last 18 months. These papers have been distributed in conjunction with the introduction of the new BDCA.

- Measurement of Capital: Bank and Deposit Companies (November 1999) which sets out the framework for capital adequacy calculation;
- Bank and Deposit Companies Act 1999: Statement of Principles (November 1999) which was statutorily required and covers minimum licensing criteria, granting and revocation of licences, powers to obtain information and reports;
- Implementation of Provisions for the Reporting and Control of Large Exposures (November 1999) which outlines the implementation approach for Section 38 of the BDCA;
- Banks and Deposit Companies: The Measurement and Monitoring of Liquidity (March 2000) which sets out the approach for measuring and assessing the adequacy of liquidity for banks and deposit companies;
- The Approach to Consolidated Supervision (January 2000) which affirms BMA's commitment to consolidated as well as solo supervision of Bermudian banks and deposit companies. The BMA supervises on both a consolidated and solo basis as evidenced by the receipt of both types of Prudential Supervision returns; and
- Bermuda Monetary Authority's Relationship with Auditors and Reporting Accountants of Banks and Deposit

Companies (August 1999): sets out the legal provisions governing the relationship between auditors and banks and deposit companies and the BMA. This paper currently remains consultative in nature, pending completion of discussions with the accountancy profession and licensed institutions.

New reporting forms (Prudential Information Returns or "PIRs") are now in place. The new forms seek to improve the capture of information on large exposures and liquidity as specified within the respective papers above.

4.3.4 **Supervision - systems and procedures**

4.3.4.1 ***Regulatory structure***

The BMA has an operating division (comprising a manager, two assistant managers and two support staff) which undertakes the day-to-day supervision of banks and deposit companies in addition to trust companies and Bermuda's one credit union. The operating division is supported by a separate Authorisation and Compliance division which is responsible for the initial vetting of corporates and individuals and by a Policy and Research division which provides legal guidance and advice on the BMA's regulatory responsibilities.

The BMA sends its senior bank regulatory personnel to meetings of the Offshore Group of Bank Supervisors.

4.3.4.2 ***Application process***

Under the BDCA the BMA is the licensing and regulatory authority for banks. Whilst section 14(2)(b) of the BDCA provides the Minister of Finance with a veto to ensure the granting of the licence is in accordance with the economic and financial policy of the Government, the decision on whether an applicant is suitable to be granted a licence rests with the BMA.

The BDCA requires that the BMA shall not grant a licence unless it is satisfied that the minimum criteria specified in the Second Schedule to the Act are fulfilled. These criteria include the "fit and proper" status of the directors, controllers and senior executives. They also require at least two people to direct the business of the licence holder and that the business itself is conducted in a prudent manner.

The Schedule also requires the applicant's Board to have non-executive directors.

There have been no new banking licences granted for many years.

4.3.4.3 ***Off-site monitoring***

The basis of the BMA's off-site monitoring is the prudential information return (PIR), which is comprehensive and submitted quarterly. The returns are reviewed by the BMA's analysts. The BMA also routinely receives and reviews copies of banks' own management accounting information packages.

The analysis of these returns provides the basis for regular routine prudential meetings with the institution's senior management which normally occur three times a year.

Ad-hoc meetings are also arranged as required at the instigation of either the BMA or the financial institutions to deal with specific issues.

4.3.4.4 ***On-site monitoring***

On-site inspections commenced in 1997 when visits took place to licensed banks, branch and subsidiary operations in the UK Crown Dependencies. These on-site inspections were conducted with the full acquiescence of the host regulators. Further visits to the UK, Ireland and Luxembourg followed.

With effect from 2000 it is intended that inspections will be expanded to cover head office functions. On-site visits to head office operations have in the past been exceptional rather than forming part of the routine supervisory process. Outline proposals for this work and for the timing of its implementation have already been given to the individual institutions and the scope has been formally decided. The BMA also proposes to visit the Cayman Islands and Hong Kong operations of its banks as the third round of its overseas on-site inspections.

4.3.4.5 ***Ongoing Requirements***

Books and records

All banks are required to maintain proper books and records in accordance with accepted international accounting standards. It is a requirement that all licensees report to BMA on a regular basis, and auditors approved by BMA must audit the financial statements of the banks on an annual basis. The BDCA provides an auditor with exemption from the general duty of confidentiality for communications by the auditor to the BMA in respect of matters relating to its role as auditor. There is also a general duty for the auditor to report matters of concern to the BMA.

The BDCA gives the BMA access to all books and records of a licence holder.

Capital adequacy

The BMA applies standard target and trigger capital ratios and does not currently differentiate between banks.

All licensed banks (on a consolidated basis) and deposit companies maintain high capital ratios.

Liquidity

A new liquidity paper has been issued by the BMA. Liquidity analysis tables have been developed and are included in the new version of the prudential information returns reviewed off-site.

Derivatives/ off balance sheet activity

We are informed by the BMA that derivatives activity is restricted in practice to interest rate and foreign exchange swaps, options, futures and forwards. The inherent risk from these products is reported by BMA to be small and they consider that the banks use derivatives primarily as risk management tools.

Whilst at the time of our visit the extent and purpose of the use of derivatives was not verified by the BMA on-site, the BMA felt that revisions to the PIR, shortly to be introduced would provide fuller and more detailed information.

Anti-money laundering

Licence holders are subject to the anti-money laundering legislation and regulatory code, which covers, *inter alia*, "know your customer" requirements.

Breach of the anti-money laundering legislation codes do not currently automatically represent a disciplinary offence by the licence holder, therefore, at present the BMA has no automatic power to take action against a licence holder for such a breach.

4.3.5 **Enforcement - systems and procedures**

The BMA has a wide range of enforcement powers. These include:

- to impose conditions;
- to revoke licences;
- to impose restrictions on licence holders;
- to make directions after surrender or revocation of a licence; and
- to petition the courts for the winding up of a former licence holder.

There is no specific power to debar individuals, but the BMA can restrict the licence via conditions, to require removal of present directors or senior executives and could, under directions, impose other steps necessary to safeguard the interest of depositors.

The BMA has power to "police the perimeter" including (with a magistrates warrant) the power of entry to carry out an investigation.

4.3.6 **Depositor protection schemes**

There are no depositor protection schemes operating in the jurisdiction.

4.4 **Issues and recommendation**

4.4.1 **Introduction**

Bermuda operates a regulatory regime that complies with all significant elements of the Basel Core Principles. This compliance was enhanced by the new BDCA which provides a modern regulatory framework.

There are some areas where enhancements are still necessary but the BMA has identified the majority of these and is taking steps to make appropriate improvements.

Furthermore, it should be noted that the BMA's strong understanding of its licence holders' businesses implies that these current deficiencies are not as material as would be the case in a jurisdiction with a larger number of licensed banks.

Specific issues for consideration are detailed below.

4.4.2 **On-site inspections**

The principal area where regulatory focus should be concentrated is in respect of the extension of the on-site inspection programme to Bermuda.

The full and effective introduction of such a local programme will assist the BMA in fully meeting the Basel Principles in the following areas:

- In carrying out an evaluation of a bank's policies, practices and procedures for loans and investments (Principle 7). The BMA receives and reviews statistical information in these areas but the suggested evaluation is not systematically undertaken by the BMA at present. We would expect the proposed on-site programme to address this issue.
- In ensuring that banks have policies, practices and procedures for evaluating the quality of assets and adequacy of loan loss provisions and loan loss reserves (Principle 8).
- In being satisfied that management information systems are in place to identify concentrations. The BMA has ensured compliance with the second part of this Principle through the issuance of its paper on Large Exposures last year. However, only full on-site verification can offer definitive comfort that adequate management systems are in place (Principle 9).
- In being satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk, market risk and transfer risk (Principles 11 and 12).
- In ensuring that banks have comprehensive risk management processes in place (including board and senior management oversight) (Principle 13). The recent on-site visits conducted overseas specifically targeted this aspect of Bermudian bank and subsidiary operations.
- In ensuring that banks have comprehensive adequate internal controls (Principle 14).
- In ensuring that banks have adequate policies, procedures and practices including "know your customer" (Principle 15).

Whilst elements of the above areas can be achieved through off-site supervision, we consider on-site verification is vital for full compliance to be achieved.

We therefore strongly support the commitment of the BMA that the first routine on-site inspections are undertaken of the banks local offices by 31 December 2000. We have received representations from the BMA that since the date of our visit an on-site inspection programme has commenced.

4.4.3 **Capital adequacy**

We support the BMA's stated intention to move towards a risk differentiated approach to capital adequacy in due course.

4.4.4 **Derivatives**

We are encouraged by the BMA's proposed development of a more detailed review process that will ensure that the banks' policies of prudent use of derivative products are in place and are adequate.

We consider that this enhancement should be monitored and should form part of the on-site as well as off-site supervisory programme.

4.4.5 **Anti-money laundering**

Whilst the BMA has made it clear to the banks in the Statement of Principles issued under the BDCA that a breach of legal provisions and codes such as in relation to money laundering constitutes grounds for disciplinary action for a breach of the prudential criteria, we consider that, to make the position absolutely clear, a breach of any anti-money laundering laws, codes, guidance or regulations should formally be grounds for disciplinary action against a licence holder, including possible revocation of its licence.

4.4.6 **Enforcement powers**

Section 17 (2) of the Banks and Deposit Companies Act 1999 gives the BMA powers to take constructive actions to assist with the management of a licensee. We do, however, consider that the BMA should have the power to appoint a person (or apply to the court for a person to be appointed) to take over the management of a licence holder, in order to safeguard the interests of depositors.

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5 Insurance

5.1 Introduction

The International Association of Insurance Supervisors (IAIS) has produced a number of principles and standards set out in a series of papers and approved by its members.

These standards recognise that the regulatory framework for insurance supervision varies from country to country and are not mandatory and do not necessarily reflect current practice in all of the member countries. The principles and standards are intended to represent a target for supervisors to work towards and can be implemented in a flexible manner, depending upon the circumstances of each jurisdiction.

The Offshore Group of Insurance Supervisors (OGIS) has also introduced a set of principles, standards and guidance notes upon which self-assessment is required. Conditions of membership of this group include, having legislation in place which enables its regulatory authority to adequately supervise insurance business by having the necessary resources and properly qualified supervisory personnel to enforce the legislation.

Of the territories under review, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of OGIS, with Anguilla having observer status. Bermuda is an active member of IAIS directly and not a member of OGIS.

The Terms of Reference for this review require us to assess performance against International Standards and good practice in the insurance sector.

It is against these standards that we have made our assessments. The areas where it is considered that development may be required are contained in the issues and recommendations section of this report.

5.2 Type and scale of activity

Bermuda has an extensive international insurance sector comprising captive insurance companies, life insurance companies and some of the largest catastrophe reinsurance companies in the world, in addition to the domestic insurance market. Bermuda dominates the captive insurance market with gross annual premiums of US$ 27 billion and total assets of US$ 115 billion. Captive businesses represent approximately 75% of the Bermuda insurance register and as self-insurers, captives do not generally deal with the public. The Bermuda market is not a significant retail market, but primarily captive and reinsurance business. As self-insurers captives do not, generally, deal with the public but rather operate business to business.

The Registrar of Companies, who undertakes insurance regulation in the jurisdiction, has supplied the following statistics regarding the total number of companies operating in different sectors as at 31 December 1998:

Long-term international life/composite insurers	134
Domestic insurance companies	18
General insurance (mostly captives and reinsurers)	1,293
(Re)insurance companies (excess liab. / property catastrophe)	12

In terms of regulation no distinction is made between insurance and reinsurance companies.

General insurance

General insurance companies can be further broken down as follows:

Class

1 Single parent captive insurance companies owned by one or more affiliates of a group and underwriting only the risks of the owners.

2 (a) Multi-owner captive insuring the risks of its owners or affiliates of its owners.

(b) A single parent and multi-owner captive insuring the risks related to or arising out of the business or operations

of the owners and affiliates, and/or deriving up to 20% of its net premiums from unrelated risks.

3 Insurers and re-insurers writing finite risk business direct third party insurance and captives deriving more than 20% of net premiums from unrelated risks, rent-a-captives and commercial carriers.

4 Insurers and re-insurers underwriting direct excess liability insurance and property catastrophe reinsurance risks.

5.3 **Factual assessment**

5.3.1 **Legislation**

Bermuda has a substantial body of legislation in place to govern the insurance sector which is set out below. Amendments and revisions to legislation take place in consultation with the Insurance Advisory Committee which comprises both public and private sector representatives.

Bermuda insurance legislation covers both domestic insurance and offshore insurance. Whilst the legislation covers both sectors, Bermuda has responded to the different requirements by providing limited discretion in relation to assets and capital adequacy subject to minimum capitalisation in respect of each different class of licence issued.

5.3.1.1 ***Insurance Act 1978***

The Insurance Act covers the registration of insurance companies, licensing, regulation, powers of the Minister, insolvency and winding-up of insurance companies.

Each class of licence is based on the risk factor of the company operating within the definition for the class of business transacted and therefore requires different levels of capitalisation.

The law requires every insurer to appoint and maintain a principal representative and office in Bermuda. The principal representative is required to ensure that the company he represents complies with the law and to report events which would adversely affect the viability of the insurers.

5.3.1.2 ***Insurance Accounts Regulations 1980***

The Insurance Accounts Regulations 1980 are arranged in three parts:

- Schedule I which sets out the prescribed form of the statutory financial statements (forms 1 — 8);
- Schedule II which advises on matters to be set out in the notes to the financial statements; and
- Schedules III, IV and V which provide instructions relating to the statutory accounting treatment of items affecting the various statutory financial statements.

5.3.1.3 ***Insurance Returns and Solvency Regulations 1980***

The Insurance Returns and Solvency Regulations cover general business and long-term business solvency margins, the minimum liquidity ratio for general business insurers and details of other criteria required for compliance with the Insurance Act 1978.

5.3.1.4 ***Proceeds of Crime Act 1998***

The Proceeds of Crime Act covers long-term insurers as regulated institutions and generally provides for such insurers to report money-laundering activities.

5.3.1.5 ***Life Act 1978***

The Life Act deals with the procedures to be undertaken in the life insurance industry including policy conditions, rules and regulations.

5.3.1.6 ***The Non-Resident Insurance Undertakings Act 1978***

The Non-Resident Insurance Undertakings Act permits non-resident insurance companies to transact domestic business within Bermuda.

5.3.1.7 ***The National Pension Scheme (Occupational Pensions) Act 1998***

The National Pension Scheme (Occupational Pensions) Act has recently been enacted. It deals with insurance-related pension business and pension fund management rules and regulations. These are not the responsibility of the insurance regulator, and as such, fall outside the scope of this review.

5.3.2 **Rules, regulations and guidance notes**

The Insurance Accounts Regulations set out detailed instructions for the completion of the necessary forms required under the Insurance Act.

The regulations are very specific and require the provision of detailed financial information. Considerable emphasis is placed on review of financial reporting documentation by the Registrar of Companies.

No specific guidelines exist. All guidance for the completion of reporting forms and compliance certificates is included in the Insurance Act and Regulations. It is not expected that any new guidelines will be issued other than by amendment to the Insurance Act or Regulations. The Regulations contained in the legislation are detailed and specific. Regular communication takes place with managers and insurers on matters of policy.

5.3.3 **Supervision - systems and procedures**

5.3.3.1 ***Application process***

Licence applications require detailed information on shareholders and directors, a complete business plan, financial projections and re-insurance programme and an actuarial report, where appropriate, and/or a loss history supporting the five year financial projections provided in the application.

A Certificate of Compliance is required from a home state regulator for a new application from an overseas company wishing to set up a subsidiary in Bermuda. Where a Bermuda company wishes to set up a subsidiary company overseas, the Registrar considers it the responsibility of that jurisdiction to decide to licence or otherwise but is willing to provide adequate confirmation supporting the company's existence and compliance with the Insurance Act 1978.

Following approval of a licence application, regulation is based upon annual financial reporting and returns. Considerable emphasis is placed on the licence application. Amendments to the business plan are not required as approval for another class of licence must be sought from the Regulator.

Changes to the business plan which occur in any company in the normal course of business are not required to be notified to the Registrar, other than where they are material and materially affect the insurer's operations, or impact on the ability of the insurer to comply with the regulations of the Insurance Act, or they would cause the insurer to change its class of licence.

Ongoing supervision is largely focused on prudential matters and is facilitated in the first instance through the annual filing of a statutory return, which is accompanied with an opinion from an approved independent auditor and the opinion of an approved loss reserve specialist and/or actuary, where applicable.

5.3.3.2 ***Segregation of business***

The Legislation does not prohibit an insurer from undertaking business other than insurance or from owning companies transacting commercial business. The Insurance Act, however, requires separate accounts and segregation of assets and liabilities of the insurance business from other business.

5.3.3.3 ***Scope of regulation***

Company management and internal procedural controls are the responsibility of both the principal representative and the insurance manager and amendments to the business plan are not notified to the regulator in all cases.

Prior to approving a change of shareholders or ownership relative to an insurance undertaking, the BMA will consult with the Registrar of Companies as to whether or not they have any objection.

5.3.3.4 ***On-site supervision***

The Department of the Registrar of Companies does not carry out any on-site inspections itself. Instead considerable reliance is placed on the work of the independent auditor's inspection of the company's books and records.

5.3.3.5 ***Off-site supervision***

Off-site reviews are based on the detailed analysis of annual statutory financial returns by the department of the Registrar of Companies.

Investments permitted for inclusion to meet statutory solvency and liquidity requirements are detailed in the Insurance Act. While each investment decision is not overseen by the regulator, the requirements of the Insurance Accounts Regulations 1980 and the relevant assets requirements of the Insurance Returns and Solvency Regulations 1980, together with the obligations of the approved principal representative and the independent auditor combine to provide guidance and examine the risks to solvency in relation to investment activity.

Whilst the valuation and safeguarding of assets are the responsibility of the Board of Directors, the reporting of compliance with the Insurance Act and associated regulations lies with the principal representative.

Re-insurance programmes are reviewed at the time of licence application and not thereafter by the Registrar unless notified by the principal representative or manager of any material inadequacies in the programme. It is the principal representative's duty to review the re-insurance programme and report any adverse conditions to the regulator.

It is the responsibility of the auditor to confirm the re-insurance receivables are valid and collectable. It is the responsibility of the principal representative to ensure that the re-insurance programme is both adequate and in force. In addition, the Registrar must be satisfied that this is the case.

5.3.4 **Enforcement - systems and procedures**

The various sections of the Insurance Act 1978 provide a wide range of enforcement powers. The regulator has the power to investigate and intervene in the activities of a licence holder; this power is utilised when required. The Registrar also has the power to withdraw a licence for reasons outlined in the Act and the power to amend licence conditions and restrictions. In addition to the Registrar's ability to present a petition for winding-up to the courts, the Minister of Finance may also direct the Registrar to petition for the winding-up of a company if the court considers it just and equitable for it to be wound-up.

5.3.5 **Policyholder protection schemes**

There are no policyholder protection schemes in force in the jurisdiction.

5.4 **Issues and recommendations**

5.4.1 **Introduction**

Bermuda has attracted major world-wide re-insurers in addition to having a leading role in the captive insurance industry. This makes the regulation of insurance a critical area to the jurisdiction.

5.4.2 **Reliance on the work of third parties**

On an ongoing basis regulatory controls are implemented mainly through the principal representative or insurance manager with whom the Registrar has regular contact. These specialist insurance management companies, owned or associated with international insurers or insurance brokers manage the offshore captive insurance companies.

As a result of this approach, considerable responsibility remains with principal representatives, insurance managers and also the auditors who are responsible for opining on the statutory accounts, the solvency certificate and the declaration of the statutory ratios.

We therefore suggest that the legal requirement to report events which would adversely affect the viability of the insurance company, be extended to include insurance managers and auditors.

5.4.3 **Change to a business plan**

In the application process a business plan and financial projection is required to be in place and approved by the Registrar. However, there is no subsequent requirement for all amendments or changes to be notified to, or approved by, the Registrar other than those described in section 5.3.3.1 above.

In a number of other jurisdictions it is a requirement for companies to not only notify the regulator of any changes to their business plan, but to obtain prior approval of the regulator before making such changes. Furthermore, we believe that, as the

term material, as referred to in section 5.3.3.1 above, is not defined in the insurance legislation it is open to varying degrees of interpretation.

We therefore recommend that, as a minimum, all amendments and/or changes to the business plan submitted at the time of the application should be notified to the Registrar immediately so that he is aware of such changes and can obtain further information if he so requires. Furthermore, we recommend that business plans should be updated annually with revised financial projections and that these should be discussed with the Registrar.

5.4.4 **On-site inspection**

There has been a recent move, internationally, towards more on-site inspections for insurance companies, limited in some jurisdictions and well established in others. The Bermuda approach has been to rely on the audit process and reporting procedures because it is felt that these procedures provide the information that would be obtained from an on-site inspection.

We consider that on-site inspections should extend beyond purely prudential matters. Furthermore, we believe that, where functions are outsourced to independent agents, the work should be subject to specific guidance from the regulator and be adequately supervised. In our opinion, the current supervisory regime for insurance does not fully meet these criteria.

5.4.5 **Reinsurance programmes**

All insurers have their reinsurance programmes approved as part of the application process. The Insurance Act 1978 requires Class 4 companies to provide, with their annual statutory filing, a schedule of ceded reinsurance as detailed in section 14A of the Insurance Returns and Solvency Regulations 1980.

At present, only Class 4 licensed companies are required to notify the regulatory authority of their reinsurance programmes, as mentioned above. For all other classes of licence, it is the responsibility of the principal representative or insurance manager to ensure that reinsurance programmes are adequate.

In several other jurisdictions such changes, irrespective of the class of licence, are not only notified to the regulatory body but approval is required prior to their taking effect.

We therefore recommend that changes to the reinsurance programme for Class 1 to 3 licences are also notified to and approved by the regulatory authority.

5.4.6 **Segregation of business**

Jurisdictions world-wide have moved to require new applicants to set-up separate companies for life and general business. IAIS has recommended that the two types of insurance business should be written in separate companies as the nature of the risks is very different. Currently there are composite insurance companies operating from Bermuda.

The regulatory authority should review the procedures currently in operation before licensing new composite companies.

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6 Securities/investments

6.1 Introduction

There are established international standards in place concerning the regulation and supervision of those involved in the securities and investments sector. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of securities and investments conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

The relevant IOSCO Principles for this section include:

- the responsibilities of the regulator should be clear and objectively stated (Principle 1);
- the regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers (Principle 3);
- the regulator should adopt clear and consistent regulatory processes (Principle 4);
- the regulator should have comprehensive inspection, investigation and surveillance powers (Principle 8);
- the regulator should have comprehensive enforcement powers (Principle 9); and
- the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme (Principle 10).

It is against the IOSCO standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

For the purpose of this report we have defined securities/investment business as covering the following range of activities:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

Legislation and regulation relating to collective investment schemes/mutual funds (referred to hereafter as mutual funds) and the Bermuda Stock Exchange are covered in the following sections.

6.2 Type and scale of activity

There are currently no available statistics on the extent of investment/securities activity in Bermuda as the legislation regulating this activity did not come into full operation until 30 June 2000.

As of the end of June 2000 38 licences to carry on investment business had been granted.

6.3 Factual assessment

6.3.1 Legislation

The conduct of securities/investment business is governed by the Investment Business Act 1998 ("IBA"). This came into effect on 1 January 2000, however, existing businesses had until 30 June 2000 to comply.

By virtue of the IBA no person may carry on investment business without a licence unless exempted.

Under the IBA investment business covers the following activities in relation to securities:

- dealing;
- arranging deals;
- managing;
- giving advice.

The IBA does not cover the operation or administration of mutual funds or the provision of custodial services, however the BMA has proposed amending the legislation to include these activities. No specific timescale has been set for amending the legislation to achieve this.

Included in the exemptions contained in the Schedule to the BMA are persons who are not market intermediaries and provide investment services exclusively for investors who are:

- sophisticated private investors;
- high net worth private investors;
- high income private investors; and
- a mutual fund approved by the authority under the Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations 1998.

Exemptions are also granted for:

- persons who provide investment services to not more than 20 persons at a time and who do not solicit the provision of such services to the public; and
- those who carry out investment business outside Bermuda from a registered office or place of business in Bermuda provided they are licensed or authorised by recognised regulatory authorities to conduct such investment business in that country or territory.

The effect of the exemptions is primarily to ensure that the IBA is restricted to market intermediaries (those who engage in the business of buying and selling securities as principal or agent) and those who deal with unsophisticated private investors. These are the areas where Bermuda feels the greatest need for regulatory protection lies as they represent the smaller and less experienced investor.

Supervisory responsibility under the Act falls to the BMA.

Under the IBA the following Orders have been issued.

"The Investment Business (Excluded Activities) Order 1999" provides additional exclusions from the definitions of investment business. These exclusions mainly concerned trustees and personal representatives.

"The Investment Business (Exemptions Order) 1999" amended Schedule 2 of the Act removing the exemption in the Act to those people doing business exclusively with non-Bermudians.

Bermuda does not have in place general legislations criminalising insider trading and market manipulation.

6.3.2 **Regulations**

6.3.2.1 ***Powers to make regulations***

Under Section 30 of the IBA the Minister of Finance may, after consultation with the BMA, prescribe regulations covering areas such as:

- regulating the conduct of investment business;
- prescribing the standards of operational capability and qualifications for any person conducting investment business;

- prescribing forms, fees and charges;
- providing for the discipline and control of investment providers or any person employed by or acting on behalf of an investment provider;
- prescribing the manner in which clients' assets are to be held in trust and preserved by an investment provider;
- prescribing capital and liquidity requirements for any person conducting investment business;
- prescribing systems for maintaining the records and controlling the operations, of an investment business;
- prescribing systems for clearing and settling securities transactions;
- regulating advertising and the solicitation of business by whatever means (including electronic solicitation); and
- the prohibition of untrue or misleading statements.

Under Section 22 of the IBA the BMA may, after consultation with the Minister of Finance, issue Codes of Conduct. These Codes may in particular cover the following areas:

- the form and content of advertisements; and
- the full and proper disclosure to clients of the capacity in which the licence holder is acting.

6.3.2.2 ***Regulations in place***

The Investment Business Regulations 1999 have been issued under Section 30 of the IBA.

These cover a number of areas including:

- contents of the Register of Licences;
- form and content of application for review;
- duty to provide confirmation note;
- duty to keep accounting records;
- minimum capital requirements; and
- liquidity requirement.

Breaches of the Investment Business Regulations are offences under Section 25 of the IBA.

On 1 January 2000 the BMA adopted two codes of conduct pursuant to Section 22 of the IBA. These were a "General Business Conduct and Practice" and an "Advertising Code of Conduct".

The "General Business Conduct and Practice" Code contains the requirements on ensuring fair dealing with customers and prohibits such acts as churning and overcharging. It also details the requirements of skill, care and due diligence and the requirements for a formal agreement with the client.

The "Advertising Code" lays down requirements for licence holders in relation to the issue of investment advertisements. It covers such areas as the accuracy and non-misleading nature of advertisements and requirements relating to the advertising of specific investments.

6.3.3 **Guidance notes**

The BMA has provided guidance notes to licence holders and prospective licence holders.

The areas covered by the Guidance Notes include:

- licensing criteria including the fit and proper test that is applied by the BMA;
- the BMA's supervisory process; and

- investment business conducted over the internet.

The Guidance Notes also contain the application form to be used including a personal questionnaire.

6.3.4 **Supervision - systems and procedures**

6.3.4.1 ***Regulatory structure***

The responsibility for licensing, supervision and enforcement is vested in the BMA. The BMA is a full member of IOSCO.

The day-to-day supervision functions in the BMA are undertaken by the Investment Division which is also responsible for the supervision of collective investment schemes. This division currently has five staff.

6.3.4.2 ***Licensing***

The BMA vets all applications for licensing. The shareholders, director and officers of the applicant are required to complete a Personal Declaration. The IBA does not, however, require a full vetting of all controllers and senior officers.

In the case of applicants who are already subject to regulation in another jurisdiction the BMA seeks confirmation from the regulator in that jurisdiction that they have no objection to the applicant seeking to establish a presence in Bermuda.

6.3.4.3 ***Off-site supervision***

The BMA requires quarterly financial reports from licence holders in addition to annual financial statements. The senior executive with responsibility for the investment business will be required to annually file with the BMA a statement of compliance with the IBA.

The statement of compliance must indicate that the licence holder was in compliance with its statutory responsibilities under the IBA, including any regulations issued under the IBA.

There is also an auditor's statement in respect of businesses holding client assets.

The BMA will also hold at least annual prudential meetings with licence holders' senior management.

6.3.4.4 ***On-site supervision***

The BMA has power to conduct on-site inspections. At the time of our visit no inspections had yet occurred as the IBA was not yet fully in force and licences were only then being issued.

The BMA proposes that all licence holders will be subject to an initial visit after which a risk based schedule will be developed. The BMA proposes that these initial visits will be conducted on an informal and voluntary basis to obtain an overview of systems, procedures and culture. However, we have been advised that detailed testing of systems and controls will be included in the subsequent on-site visits. The BMA has access to client files for the purposes of its on-site inspection.

6.3.5 **Enforcement - systems and procedures**

6.3.5.1 ***Licence holders***

Under Section 20 of the IBA the BMA has power to require from a licence holder the production and submission of relevant documents and information.

The BMA can vary, suspend or cancel licences; it can also give direction to ensure compliance. It can also appoint a custodian or manager to manage the investment business and safeguard assets.

Under Section 19 of the IBA the Authority can appoint an inspector to investigate the affairs of a licence holder.

The BMA has power to seek the winding up of a former licence holder on just and equitable grounds. There is no power to apply to the court to wind up a firm which is still a licence holder.

6.3.5.2 ***Non-licence holders***

Contracts in connection with investment business where a person has breached the requirement to be licensed are unenforceable by that person. In addition persons who carry on investment business without a licence (where one is required)

are guilty of an offence punishable on conviction on indictment to a period of imprisonment of up to five years. This provides a strong deterrent to persons attempting to undertake unlicensed activities in Bermuda.

However, in respect of persons who are suspected of undertaking investment business without the appropriate authorisation, the BMA's power under Section 19 of the IBA to appoint an inspector does not apply. Nor are there powers under the IBA for the BMA to take action against persons suspected of acting in breach of the legislation, other than via the court in specific circumstances. As a criminal offence, such matters are dealt with by the police.

6.3.6 **Publicly available information**

Under the IBA the BMA is required to publish in the Gazette notice of every grant of a licence.

Additionally the BMA keeps a publicly available register containing:

- the name of the licence holder;
- their address;
- the date of grant (and expiry if applicable) of the licence;
- any conditions imposed;
- any variation to the conditions; and
- the date of suspension or cancellation of the licence (if applicable).

The BMA have advised us that they propose to make this information available on the World Wide Web.

6.3.7 **Investor compensation scheme**

There is no compensation scheme in place in respect of securities/investment business.

6.4 **Issues and recommendations**

6.4.1 **Introduction**

The IBA and the proposed supervisory and enforcement process represent significant movement towards achieving IOSCO standards. In many respects, the IBA will enable compliance with those standards. In particular, ability to access to client files during the regulatory process is a key requirement for any effective on-site inspection.

There are a number of areas where we consider further enhancement is necessary to achieve full compliance with IOSCO standards and these are outlined below.

6.4.2 **The IBA**

We note that the BMA has identified a number of regulatory weaknesses in respect of the IBA and has undertaken to act on them. These include:

- the need to provide more directly for the prudential vetting of controllers, directors and senior executives of investment businesses (the current provision only extends to the senior executive responsible for the investment business);
- the absence of regulatory coverage of those engaged in the operation and administration of mutual funds or the provision of custodial services;
- the need for provisions prohibiting insider dealing and price manipulation, beyond the current provisions relating to investment providers and Bermuda Stock Exchange members;
- that the existing capital adequacy provisions are inadequate to deal with investment businesses undertaking material positions or trading risks;
- that there is no requirement for consolidated supervision contained in the IBA; and

- the need to enhance the BMA's ability to co-operate with other regulators. This is in the areas of compulsory powers and gateways.

It is reassuring to note that these areas have already been identified and action proposed in advance of this review.

6.4.3 **Exemptions from the IBA**

We consider the restriction of scope of the IBA to market intermediaries and those providing services to unsophisticated private investors to be too narrow. Whilst the regulations which apply to persons who deal with different categories of investment business or different categories of client may vary, the principal requirement should be that all persons engaged in investment business be verified as being "fit and proper" and licensed. It is also important that a regulator has power to take action against anyone engaging in this activity in an inappropriate manner. Furthermore, it is important that investors who may receive a lower level of regulatory protection are aware of this fact.

6.4.4 **Enforcement powers**

The BMA currently lacks full powers to "police the perimeter", that is, investigate situations where investment business may be being carried on in breach of the IBA. Currently any such investigation would be usually undertaken by the police as a suspected criminal offence although there is a power to go to the courts for injunctive relief in the case of non-licensed persons carrying on business in contravention of the prohibition or where the court is satisfied there is a reasonable likelihood of such a contravention.

We consider this to be a weakness, as the BMA are in a better position than the police to perform this function given their understanding and experience in this area. This inability also means that the powers available in relation to licence holders (excluding the power to petition the courts for winding up) are not available for use against those acting in breach of the IBA.

We consider it would be helpful if the BMA's powers to petition the courts to wind-up a non-licence holder could be extended to licence holders. This would avoid the necessity of revoking a licence (and therefore losing some regulatory control) before a petition is made.

6.4.5 **Anti-money laundering**

Whilst we accept that a breach of the anti-money laundering code could be considered not being "fit and proper" we consider that, to make the position absolutely clear, a breach of any anti-money laundering laws, codes, guidance or regulations should formally be grounds for disciplinary action against a licence holder, including possible revocation of its licence.

6.4.6 **Regulatory resources**

Whilst resources have been allocated to the supervision of licence holders, the need for on-site supervision and the additional activities which it is proposed be included means that these resources may not be adequate. However, this cannot be gauged with certainty at this point.

We therefore consider that the adequacy of current resources needs to be closely monitored.

The BMA has experience in the on-site inspection of the overseas investment operations of licensed banks. However, we consider that, as this legislation is new there is inevitably a lack of direct experience in the supervision of licence holders, particularly on-site.

Therefore, we consider that a structured training programme in investment business supervision should be instituted.

6.4.7 **Supervisory process**

On-site supervision

Whilst the supervisory process, particularly the on-site process, has not yet been finalised; the proposed approach to on-site inspection appears to be in accordance with IOSCO Principle 8 and good practice. We particularly note that the proposed BMA on-site visit structure includes substantive testing of compliance with the regulatory requirements, as well as prudential discussions with the licence holder. The verification of compliance with conduct of business requirements can only be effectively achieved through such an approach.

We consider that any on-site supervisory regime developed for investment businesses should pay particular attention to the

methodology for supervising licence holders with no real presence in Bermuda.

6.4.8 **Additional supervisory checks**

Licensing

Where applicants are already subject to regulation in another jurisdiction, the BMA seeks confirmation from the regulator in that jurisdiction that they have no objection to the applicant seeking to establish a presence in Bermuda. This should be followed up with ongoing information sharing arrangements to enable co-ordinated cross-border supervision to occur.

Off-site supervision

We consider that, provided off-site monitoring requirements are supplemented by notification requirements under which the licence holder must advise the BMA on the occurrence of certain specified events (for example, an error resulting in a client loss), these procedures will be in accordance with IOSCO Principles 8 and 10 and good practice.

6.4.9 **Public register**

We consider that making the register available on the World Wide Web is a very positive action.

We do, however, consider the information on the file could be enhanced to provide full transparency, should therefore be expanded to include details of directors and senior officers.

6.4.10 **Insider trading and market manipulation**

The OECD Principles consider these activities are a breach of good corporate governance as they violate the principle of equitable treatment of shareholders. As Bermuda does not have insider trading or market manipulation legislation in place this principle is not currently being complied with.

We therefore recommend that legislation criminalising insider trading and market manipulation legislation be put in place.

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7 Collective investment schemes

7.1 Introduction

There are established international standards in place concerning the regulation and supervision of collective investment schemes. The Terms of Reference for this review require us to look at whether the arrangement for the regulation of collective investment schemes conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

Among the IOSCO Principles there are specific principles relating to collective investment schemes. These are:

- that the regulatory system should set standards for the licensing and the regulation of those who wish to market or operate a collective investment scheme (Principle 17);
- the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client money and assets (Principle 18);
- regulation should require (full, timely and accurate disclosure of financial results and other information) which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme (Principle 19); and
- regulations should ensure that there is a proper and disclosed basis for asset valuation and the pricing and redemption of units in a collective investment scheme (Principle 20).

Other Principles, particularly regarding the regulator, enforcement and co-operation also apply to the regulation and supervision of schemes.

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

7.2 Type and scale of activity

Bermuda is a significant centre for collective investment schemes and has legislation in place regarding their regulation and supervision. As at 31 March 2000, the number of collective investment schemes operating within Bermuda was 1,301 with US$36.7bn in funds under management.

Bermuda recognises two legal types of collective investment scheme. These are mutual fund companies and unit trusts. Over 90% of schemes in Bermuda are companies.

There are three categories of collective investment schemes in Bermuda. Within each of the three categories there are a number of sub-schemes which in total represent the number of collective investment schemes operating in Bermuda. The three categories of schemes are Recognised/UK Class schemes, Standard schemes and Institutional schemes. Apart from in the case of UK Class schemes, Bermuda is not currently readily able to break down the number of schemes into their respective classes. We are informed that the BMA are working to improve their database to facilitate this.

Recognised/United Kingdom Class schemes

Bermuda is a "designated territory" pursuant to Section 87 of the United Kingdom Financial Services Act. Under this designation the UK permits access to its market for schemes from Bermuda which are regarded as providing equivalent protection to that provided under the UK Financial Services Act. The Bermuda schemes covered by this designation are known as United Kingdom Class schemes ("UK Class" schemes).

As at 31 March 2000 there were 3 UK Class schemes.

Bermuda is in the process of replacing such schemes with a new type of scheme, known as "Recognised" schemes and has submitted the revised regulatory structure to the UK for confirmation that this structure provides equivalent protection to that

in place in the UK. As this process has not been finalised there are, as yet, no Recognised schemes in existence.

Standard schemes

These can be offered to retail or institutional investors. The regulation of these schemes is contained in the Regulations for Collective Investment Schemes 1998.

Institutional schemes

These are a special category of scheme which may only be offered to institutional or sophisticated investors. As such, they are subject to a less comprehensive regulatory and supervisory regime.

7.3 Factual assessment

7.3.1 Legislation

The main pieces of legislation relating to collective investment schemes are:

- The Companies Act 1981 which provides the definition of a mutual fund;
- The Stamp Duties Act 1976 which provides the definition of a unit trust; and
- The Bermuda Monetary Authority Act 1969 which provides the powers for the regulations relating to the operation and supervision of collective investment schemes.

7.3.1.1 *Limited partnerships*

As the definitions of collective investment schemes are contained in the Companies Act and Stamp Duties Act and there is no generic definition, limited partnerships fall outside the ambit of the regulations even if they do meet the standard definitions of a collective investment scheme. We have been advised by the BMA that some limited partnerships are operating as collective investment schemes in Bermuda.

7.3.2 Regulations

7.3.2.1 *Introduction*

With the exception of UK Class schemes, the regulation of collective investment schemes is governed by the Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations 1998 (The "Regulations").

UK Class schemes are regulated under a statutory instrument, "The Companies (the United Kingdom Class Schemes Bye-Laws) Regulations" 1988. It is intended these regulations will be replaced by the Recognised Scheme Regulations.

The BMA are currently proposing the introduction of more detailed regulatory requirements for Standard schemes.

7.3.2.2 *Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations*

These regulations include the requirement to disclose information material to an investor's decisions.

All schemes must have a custodian approved by the BMA. Normally this must be a financial institution in Bermuda or the subsidiary of such an institution. Institutional schemes are exempted from the requirement to have a Bermudian custodian.

7.3.2.3 *The Companies (the United Kingdom Class Schemes Bye-Laws) Regulations*

Under these regulations, UK Class schemes are subject to significant regulatory requirements. These include regulations relating to:

- investment and borrowing powers;
- segregation of client assets;
- disclosure of information material to investor's decisions;
- disclosure of asset valuation and pricing;

- the issue and redemption of units/shares; and
- the constitution and management of the scheme.

These regulations have been reviewed and approved by the UK Treasury as providing equivalent protection to that provided under the UK's own Financial Services Act.

A UK Class scheme must have a Bermudian bank as custodian and a Bermudian incorporated company as manager. The manager and custodian must be independent of each other. Recognised schemes will be subject to the same requirement when they are brought into effect.

7.3.3 **Guidance notes**

The BMA has issued guidance on general points relating to the operation of collective investment schemes. This includes details of the characteristics of the different class functions and information that has to be submitted to the BMA.

7.3.4 **Supervision - systems and procedures**

7.3.4.1 ***Regulatory structure***

The supervision of collective investment schemes is the responsibility of the BMA.

The BMA is a full member of IOSCO and the Offshore Group of Collective Investment Scheme Supervisors.

7.3.4.2 ***Licensing***

Prior to an application being approved, the BMA performs an assessment of whether the applicant is fit and proper.

This includes a Lexis-Nexis or Dow Jones media search on key individuals and, where the applicant is subject to regulation elsewhere, the BMA liaises with overseas regulators on an exceptions basis with regard to the applicant's previous history.

The applicant is also required to provide résumés on relevant individuals to check that they are competent to carry on the functions they have applied to undertake.

In addition to the above, the application must contain details of the proposed fund service providers.

There are additional information requirements for UK Class schemes and Recognised schemes.

7.3.4.3 ***Foreign schemes***

Foreign collective investment schemes managed or administered from Bermuda, are not subject to regulation. There is, however, initial vetting as they are regarded as carrying on business in Bermuda and are therefore subject to the same beneficial owner vetting as other foreign companies.

The Bermuda authorities are currently considering lifting the requirement for initial vetting if fund administrators come under the regulatory scope. The reason for this is that the responsibility for vetting would then pass to the administrator as part of its regulatory obligations.

7.3.4.4 ***Off-site supervision***

Off-site supervision focuses on the receipt and scrutiny of monthly reports detailing net asset values and net subscription/redemption figures. Unusual fluctuations are assessed and questioned. Audited financial statements are also required.

7.3.4.5 ***On-site supervision***

Apart from UK Class schemes, where regular inspections are undertaken by the BMA, no on-site supervision is currently undertaken. Indeed, in respect of Standard and Institutional schemes, the BMA only has power to undertake an inspection where a scheme refuses to submit relevant information.

7.3.4.6 ***UK Class schemes***

The supervision in place for UK Class schemes is itself subject to periodic on-site review by the UK Treasury as part of its

ongoing monitoring to ensure that Bermuda still meets the requirements to be a designated territory.

No review has taken place since 1994.

7.3.4.7 *Proposed changes*

The BMA are currently considering introducing broader supervisory powers in respect of standard and institutional schemes. However, no definitive decision on this has been made.

7.3.5 Enforcement - systems and procedures

The BMA has enforcement powers, including rights of inspection, in relation to UK Class schemes. As stated above, the BMA only has a power of inspection in relation to Standard and Institutional schemes where the scheme refuses to submit relevant information. In the case of mutual funds companies, the Minister of Finance does have the power to appoint an inspector under the Companies Act.

The BMA has the power to revoke an approval given under the Regulations.

Under the Companies Act there is also a power, as there is in respect of any other company, for the Minister of Finance to petition the courts for the winding up of a collective investment scheme on just and equitable grounds. There is no similar power for a unit trust. Nor is there any direct power for the BMA to make a petition.

7.3.6 Investor compensation scheme

With the exception of the scheme covering investors in UK Class schemes there are no compensation schemes in place. UK Class schemes compensation arrangements mirror those of regulated schemes in the UK.

7.4 Issues and recommendations

7.4.1 Introduction

Bermuda has in place many necessary components for a well regulated-collective investment scheme sector, particularly in relation to UK Class schemes. There are, however, a number of enhancements which need to be made. These particularly relate to the regulation and supervision of standard schemes. This is of importance as standard schemes make up the majority of collective investment schemes in Bermuda.

The areas in need of development are considered below.

7.4.2 Public/non-public schemes

Our evaluation draws a distinction between public and non-public schemes. For the purposes of Bermuda we consider that Institutional schemes are non-public. Therefore, whilst Bermuda's regulation of them is not technically to IOSCO standards (as IOSCO does not distinguish between public and non-public schemes), the approach taken by Bermuda is similar to that taken to non-public schemes by many other jurisdictions including the United States. Indeed a number of jurisdictions exercise no regulatory control over certain non-public schemes.

In general, we consider that, non-public schemes should be subject to initial vetting and that enforcement and supervisory powers should exist. However, in line with general international practice, there need be no specific requirements along the lines envisaged by IOSCO Principles 18, 19 and 20 because of the nature of the investors involved. In the case of Bermuda there is adequate vetting but the enforcement powers require improvement.

7.4.3 Ongoing supervision

7.4.3.1 *Off-site supervision*

With the exception of UK Class schemes, there is currently limited off-site supervision, with focus primarily being on variations to a scheme's performance and review of self-certification compliance certificates.

We consider that off-site monitoring should be designed to enable the BMA to assess the activities of a fund and to identify potential risk areas which may be evidence of a regulatory breach or increase the likelihood of such a breach in the future. This should be achieved through a formal documented review programme.

Such a programme should include the receipt and monitoring of the annual audited accounts of schemes. There should also be a requirement for breaches of the regulations or the fund's constitutional documents to be notified to the BMA.

The details of fund composition should be compared against the fund's constitutional documents to ensure that the composition is in accordance with the fund's objectives and asset holding policies.

In the case of public funds we agree with the BMA that the introduction of an enhanced off-site monitoring programme must, therefore, now be a priority. Until such a programme is instituted Bermuda will not be in full compliance with IOSCO Principle 10.

IOSCO Principle 19 requires that supervision should ensure that the stated investment policy or trading strategy of the scheme has been followed and any restriction on the type or level of investment complied with. This is not, at present, occurring and therefore should be introduced for Standard class schemes.

7.4.4 **On-site supervision**

We consider that the present restriction on the ability of the BMA to conduct on-site inspections in respect of Standard schemes results in a failure to comply with IOSCO Principles 8 and 10.

We also consider that there is not currently compliance with IOSCO Principle 20 in respect of Standard class schemes. This Principle requires the regulator to seek to ensure that all the property of a scheme is fairly and accurately valued and that the net asset value of the scheme is correctly calculated. This assessment is best achieved during an on-site inspection.

In order to meet this Principle we believe that the restriction should be removed and that the BMA should have the right to conduct on-site inspections without the pre-condition of a failure by the scheme to provide information. Such a power of inspection should cover access to all functionaries for the purpose of ascertaining compliance with the appropriate regulations.

7.4.5 **Enforcement powers**

Whilst the BMA's enforcement powers cover many of the requirements of IOSCO Principle 9, we consider that some enhancements would assist in achieving full compliance.

We consider that the BMA should have formal powers to "police the perimeter" thereby allowing it to investigate potential unlicensed scheme activity.

Additionally, whilst the Registrar of Companies has the power to apply to wind-up a company operating as a scheme, we consider that the BMA should also have powers to apply to the court to wind-up such companies and furthermore to take similar action in respect of unit trusts and, when regulated, limited partnerships.

The BMA should be able to:

- require the substitution of any service provider to the scheme;
- apply to the court to appoint a custodian to manage the assets of a scheme;
- fine a scheme for breaches of the law or any regulations; and
- issue directions.

7.4.6 **Regulations**

There are no specific regulatory requirements for Standard Schemes for the following:

- segregation of client assets; and
- disclosure of the basis of asset valuation and pricing and the issue and redemption of units/shares.

However, we are advised by the BMA that this is achieved through the BMA's review of the schemes constitutional documents. The BMA state that they will not approve documents which do not contain the necessary disclosures.

Nevertheless, we consider a more formalised regulatory structure would be preferable and would better comply with IOSCO Principles 3 and 18. In particular, how segregation of assets will occur needs to be formally regulated.

We therefore recommend that formal requirements are included in the revised regulations to be introduced for Standard Schemes.

7.4.7 **Regulatory scope**

The lack of a single definition of collective investment schemes has resulted in limited partnerships not being covered within the regulatory scope. This has left schemes in the form of limited partnerships unregulated. We consider that it is important that these are brought within the regulations. We also consider that the opportunity should be taken to create a single definition of schemes rather than rely on the different definitions contained in the Companies Act and Stamp Duty Act.

We are advised by the BMA that this can be achieved by an amendment to the BMA Act.

7.4.8 **Designated territory status**

The length of time since the last UK Treasury review means that we consider that a further evaluation of Bermuda should be undertaken by the UK Treasury as soon as possible, to confirm whether the regulatory requirements for UK Class Schemes/ Recognised schemes remain equivalent to UK regulatory requirements.

7.4.9 **Foreign schemes**

The BMA currently proposes to pass the vetting of foreign incorporated schemes to scheme administrators. This approach is not out of line with IOSCO Principles. Nevertheless, we consider that the BMA, in order to help guard against the reputational damage of a fraudulent scheme to a Bermudian administrator, may wish to continue to vet these schemes at the point of entry as the BMA's access to external information is greater than the administrators.

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8 Stock exchange

8.1 Introduction

There are established international standards in place concerning the regulation and supervision of stock exchanges. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of these exchanges conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

The IOSCO principles which relate to the oversight and regulation of stock exchanges are as follows:

- Self-regulation (principles 6 and 7);
- Issuers (principles 14 to 16);
- Market Intermediaries (principles 21 to 24); and
- The Secondary Market (principles 25 to 30).

The principles for self-regulation address two supervisory relationships. The first of these covers the supervisory activities of the exchange as a self-regulatory organisation ("SRO") and is addressed in this section of the report. The second principle relates to the oversight by the regulator of its SRO and is covered in the section on the regulatory authority.

8.2 Type and scale of activity

The BSX has been in operation since 1971 and initially operated as a purely domestic exchange. This role was extended in 1992 to include international activities. As part of this process the BSX has aimed to position itself as a niche exchange focusing on "adding value to Bermuda's specialist markets, offshore insurance, mutual funds and telecommunications".

In 1996 the BSX was granted Designated Offshore Securities Market (DOSM) status by the US Securities and Exchange Commission. BSX is also a member of the International Federation of Stock Exchanges ("FIBV") and an affiliate member of IOSCO.

BSX introduced International Listing Regulations in November 1995 which are designed to give Bermuda a competitive edge in certain key niche markets and to provide a platform to develop an international offshore capital market.

The BSX is independently owned, operates as a "for profit" entity, and is governed by a council elected annually by its shareholders.

The BSX currently has 18 trading members and four listing sponsors. The following markets are operated and contain listed instruments:

- domestic equity (main board and small capitalisation stock board);
- domestic debt;
- international equity;
- international debt;
- Mezzanine market; and
- international mutual funds.

The Mezzanine Market provides a primary listing for international issuers which is restricted to Qualifying Investors who are high net worth individuals and institutional investors.

In addition, the BSX has rules covering depository receipts and insurance related securities but no instruments of these types are currently listed. No trading has occurred to date in any of the listed mutual funds as investors can deal directly with the fund manager.

Typical daily domestic equity trading volumes are approximately 30,000 shares. The daily crosses originating from the New York Stock Exchange ("NYSE") averaged 73 million shares per day during 1999.

8.3 **Factual assessment**

8.3.1 **Legislation**

The BSX is subject to the Bermuda Stock Exchange Company Act 1992. By virtue of it being defined as a financial institution under the Third Schedule of the BMA Act, the activities of the BSX are subject to the supervision, regulation and inspection by the BMA.

The Investment Business Act 1998 requires that all members of the BSX which act as market intermediaries should hold an investment business licence. All new applicants must obtain a licence and existing members had until 30 June 2000 to be licensed.

8.3.2 **Rules and regulations**

The BSX is regulated by the BMA.

The BSX Trading Membership Regulations set out the initial requirements and ongoing obligations for those entities seeking trading membership privileges. In addition, members must comply with the Trading Rules, Code of Conduct and Settlement rules.

All new listings are brought to the market by a listing sponsor whose activities are governed by the Listing Sponsor Regulations. Listing rules covering qualifications for listing, the application procedures and requirements and an issuer's continuing obligations, are in place for all domestic and international markets.

8.3.3 **Guidance**

The BSX circulates practice notes for its users and has a practitioner's Guide Book on Listing.

8.3.4 **Supervision - systems and procedures**

Market intermediaries by virtue of holding an investment business licence are subject to supervision by the BMA. At the time of our visit no licences had been granted under the Investment Business Act 1998; with the exception of the initial vetting process, no supervisory activities had been undertaken. Currently the BMA's supervision of the BSX involves quarterly meetings with the BSX executive, although such meetings previously had taken place on a monthly basis. In addition, the BSX submits monthly management accounts and audited annual financial statements.

The BSX carries out vetting procedures for its new members. In addition, there are checks carried out by the BMA in its capacity as official regulator. The need to obtain an investment business licence could potentially increase the number of areas where vetting procedures are duplicated.

The BSX monitors all trading activity on a real time basis through its fully electronic central limit order book trading platform. A live terminal is also situated in the Investment division of the BMA.

Monitoring of members' minimum capital requirements is carried out through periodic reporting by the member to the BSX.

The listing rules require varying levels of disclosure depending on the market and impose continuing obligations on issuers. The rules give the BSX the power to make enquiries of its listed issuers which are backed by sanctions for non-compliance.

A trading member must make all books of account and records required to be kept under the rules available to the BSX and the BMA. The BSX has the power to conduct on-site inspection visits of its member firms but has not undertaken any visits to date.

8.3.5 **Enforcement - systems and procedures**

The BSX can censure, whether it be in private or public, fine, change a member's status (that is to say, remove its ability to sponsor or deal, if authorised to act in both capacities) or expel a member. This extends to the individuals who are carrying out exchange business.

The rules of the BSX give it the power to make enquiries of listed issuers.

8.3.6 **Investor protection scheme**

The BSX is in the process of establishing a trade guarantee mechanism to guarantee all trades settled in its new fully integrated trading and settlement system. This is intended to include a trade guarantee fund in cash and an insurance element. However, there is currently no such scheme in place.

8.4 **Issues and recommendations**

8.4.1 **Introduction**

The market of the BSX has grown slowly based on domestic securities, the listing of funds and international securities. The volume on the BSX is generated by crosses originating from securities listed on the New York Stock Exchange. This is driven by two considerations, namely price and the need to transparently report these trades. This will be subject to change when the decision by the NYSE to drop rule 390 (which requires the reporting of such crosses on a recognised exchange) takes effect.

Trading occurs via an electronic limit order book system which provides a real time feed into Bloomberg.

The BSX is moving towards a clearing and settlement system whereby all securities traded on its automated system will be matched, cleared and settled through an automated platform. Registration will be centralised and trading will be de-materialised. This will in essence only add full automation to a process which is already operating generally in line with IOSCO Principles.

8.4.2 **Supervision**

Member firms are regulated purely by means of off-site information and consultation. No on-site visits have been carried out. This is not in line with IOSCO Principles.

Having regard to the size of the market, there are sufficient staff resources available to monitor secondary market activity. However, as good practice dictates, and more importantly given the high risk nature of certain securities traded, it is essential for a dedicated supervision area to be established.

This area should cover supervision and on-site inspections. Such visits must be carried out on all categories of member including the listing sponsors to ensure compliance with BSX rules. We are advised that BSX trading members will be subject to on-site inspections under the Investment Business Act.

8.4.3 **Listings**

There has been an introduction of listed instruments which are high risk onto the Mezzanine Market. These are well signalled to investors and are aimed at high net worth individuals and institutional investors. As a result there is reduced regulation with respect to these instruments as is the case for similar instruments in other jurisdictions.

Rules are in place to cover primary and secondary market integrity including false and misleading information, insider trading and false markets. However, the listing rules do not specifically provide against false or misleading information which we consider to be contrary to the IOSCO Principles for issuers.

Although the BSX is comfortable with this arrangement, on the basis that there are a number of rules and requirements to ensure that investors have accurate and timely information to prevent the creation of a false market, it has confirmed that it will be content to include the point specifically in its rules when these are next amended.

8.4.4 **Money laundering**

The BSX is exempt from the proceeds of crime and money laundering legislation although there remains a duty to report suspicious transactions. We are informed that this position arises as a consequence of the practical difficulty of compliance

with certain of the know your customer obligations. The BSX currently has no memoranda of understanding. However, there is evidence of co-operation with overseas regulators.

These issues are considered for the jurisdiction as a whole in the section on international co-operation.

8.4.5 **Liaison between the BSX and the BMA**

We understand that the BMA and BSX will continue to meet regularly at a number of levels within the two organisations. Although the frequency of higher level meetings covering prudential matters has recently changed from monthly to quarterly, this change reflects the corresponding increased frequency of working contacts within the BSX and the investment division of the BMA.

The BMA and the BSX should consult and agree the responsibility for carrying out checks on new applicants for BSX membership and IBA licences to avoid unnecessary duplication of effort.

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9 Companies

9.1 Introduction

As recognised by the Terms of Reference, there are no specific international standards concerning the regulation and supervision of companies. However, there are a number of international standards concerning the operation and management of companies. These include the OECD "Principles of Corporate Governance", the G7 "Report on Transparency and Accountability" and the IMF "Guide to Progress in Strengthening the Global Financial Architecture". There is also the work of the International Accounting Standards Committee. Whilst other international standards exist, these primarily relate to particular financial services activities such as banking, securities and insurance and many of their requirements are not directly applicable to ordinary trading and holding companies.

The OECD Principles cover:

- the rights of shareholders;
- the equitable treatment of shareholders;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board of directors.

The Guidance Notes cover the following additional issues with regard to companies:

- the ability of law enforcement and regulatory authorities to identify the shareholders and directors of a company and the beneficial owners of a company's shares;
- the availability of financial information relevant to the activities of companies to law enforcement and regulatory authorities;
- the requirements concerning accounting disclosure and auditing practice, particularly where there are obligations to third parties;
- the circumstances in which accounts should be produced and when accounts should be made public; and
- standards of corporate governance.

The TOR and the Guidance Notes cover companies and company service providers together. This is necessary because a proper consideration of the issues involves both. However, we consider that it is useful to consider them separately, which we have done in this Report.

We consider that the regulation of company service providers is the most practical and effective way of deterring the abuse of company structures and of ensuring that relevant information is available to law enforcement and regulatory authorities. This approach is in accordance with the views expressed in the recent UK Home Office "Review of Financial Regulation in the Crown Dependencies" (Section 13.4.1). Nevertheless, there are areas where the requirements imposed upon companies themselves need to be enhanced.

In considering these enhancements, we have not undertaken a review of company or insolvency law as a whole. The TOR do not require us to do this. Instead we have assessed the legislation and regulation of companies in Bermuda against the criteria in the Guidance Notes as set out above.

9.2 Type and scale of activity

Two types of company may be incorporated in Bermuda, local companies and exempted companies.

As at 31 March 2000 there were 2,528 active local companies on the registry, 169 having been incorporated during the previous 12 months.

As at 31 March 2000 there were 10,771 active exempted companies on the registry, 1,408 having been incorporated during the previous 12 months.

No information was made available concerning the uses to which exempted companies are put or concerning the main markets for the companies.

9.3 **Factual assessment**

9.3.1 **Legislation**

There is one piece of corporate legislation in Bermuda, the Companies Act 1981 (as amended "CA"). The CA covers the incorporation, administration and operation of all types of companies in Bermuda and provides for ancillary matters such as financial disclosure, insolvency and winding up.

The CA is administered by the Registrar of Companies ("the Registrar").

A company may be:

- a company limited by shares;
- an unlimited liability company; or
- a company limited by guarantee.

Every Bermudian company must have a registered office in Bermuda. Notice of the situation of the registered office must be filed with the Registrar and is a matter of public record.

The CA does not contain the concept of a registered agent.

The provision of registered office services is not a regulated activity in Bermuda.

The directors of every company are required to lay audited accounts before the general meeting of the company unless all the members and all the directors of the company resolve otherwise.

9.3.1.1 ***Local companies***

A company controlled by Bermudians is a local company. For these purposes control means that:

- at least 60% of the total voting rights in the company are exercisable by Bermudians;
- at least 60% of the directors of the company are Bermudian; and
- at least 60% of the shares of the company are beneficially owned by Bermudians.

Local companies may carry on business in or outside Bermuda.

9.3.1.2 ***Exempted companies***

An exempted company is exempted from certain provisions (primarily local ownership provisions) of Bermuda law that apply to local companies. Exempted companies are therefore predominately owned by non-Bermudians and, although incorporated in Bermuda, may carry on business from within Bermuda normally only in connection with transactions and activities external to Bermuda.

9.3.1.3 ***Limited duration companies ("LDCs")***

LDCs are also permitted.

9.3.1.4 ***Directors***

Only an individual can act as the director of a Bermudian company.

The CA requires the directors of a company to present financial statements audited in accordance with generally accepted auditing standards to the members of the company, except as otherwise provided under the CA.

9.3.1.5 ***Foreign companies and continuation of foreign companies as exempted limited liability companies***

A body incorporated outside Bermuda may apply to the Minister of Finance for consent to be continued in Bermuda as an exempted limited liability company.

All overseas companies wishing to carry on business in Bermuda must obtain a permit ("foreign companies").

9.3.2 **Regulations, rules and guidance notes**

The "Companies (Winding-Up) Rules 1982" provide for the administration of compulsory and voluntary liquidations and associated matters.

The BMA has issued guidance notes with regard to its policy relating to incorporations and detailing requirements under the law.

9.3.3 **Supervision - systems and procedures**

9.3.3.1 ***Regulatory structure***

The Registry of Companies has 37 staff consisting of clerical staff and management. All the staff, except the clerical grades, have a minimum of a bachelor's degree, senior management requiring postgraduate degree and/or a professional qualification.

9.3.3.2 ***Applications for incorporation***

The BMA undertakes vetting checks on proposed shareholders and beneficial owners of companies seeking to be incorporated under the CA on behalf of the Ministry of Finance. For these purposes, the BMA utilises online information sources such as Lexis/Nexis and Dow Jones. Assistance is sometimes sought from the Commercial Crime Unit of the police force, overseas regulatory authorities and the Commercial Crime Services of the International Chamber of Commerce.

The Lexis/Nexis and Dow Jones checks cover all shareholders and beneficial owners notified to the BMA. Other checks are generally made where the initial check highlights an issue of concern or indicates a need for further investigation.

Vetting checks are not carried out on proposed directors other than in the case of financial institutions.

9.3.3.3 ***Ongoing supervision***

The Registrar is responsible for maintaining the registers of companies and for registering documents filed. Although some basic checks may be undertaken, this is essentially a recording function.

As in most jurisdictions the role of the Registrar is not a regulatory one, aside from ensuring compliance with filing requirements, there is no ongoing regulatory supervision of companies.

9.3.4 **Enforcement - systems and procedures**

The enforcement powers available in respect of companies are described below.

9.3.4.1 ***Inspection***

The Minister of Finance may appoint an inspector to investigate a company. This power extends to exempted and overseas companies.

9.3.4.2 ***Striking off***

A company can be struck off the Register of Companies by the Registrar if the Registrar is satisfied that it has ceased to carry on business or is not in operation.

There is no direct power to strike off a company for failure to make returns or pay the prescribed fees although the failure to pay fees is treated as evidence that a company has ceased to carry on business.

9.3.4.3 ***Winding-up***

The Registrar of Companies may petition the Court for the winding-up of a company on just and equitable grounds.

9.3.5 **Publicly available information**

All information maintained at the Companies Registry is available for public inspection.

Section 66 requires that the register of members of a company is kept at its registered office or in another place in Bermuda approved by the Registrar. The Register is open to members and, for a charge of $5, to any other person.

9.3.6 **Non-public information**

The audited accounts of a company are not available to the general public through the Registrar.

9.3.7 **Directors**

Section 97 of the Companies Act sets out the roles and responsibilities of directors. However the Act does not provide for the disqualification of directors, on fit and proper grounds other than bankruptcy or criminal conviction.

Corporate directors are not permitted.

There is no requirement for a company to notify the registry of the names of the directors or any change (apart from the directors at formation). However, we do note that all registered companies (other than companies whose objects are exclusively charitable) must keep a register of directors which must be open to the public during all business hours.

Section 130 of the Act provides certain powers for the resident representative including the right to attend board meetings. The resident representative is required to notify the Registrar if he becomes aware of any transfer of shares effected in contravention of any statute.

9.3.8 **Beneficial ownership**

All companies, including foreign companies registered under the CA must disclose their beneficial ownership.

Bermuda requires disclosure to the Minister of Finance or his designate of the beneficial ownership of all companies registered in Bermuda (including overseas companies doing business in Bermuda).

An exemption to this requirement can be given ("free transfer exemptions") in certain situations where the frequency of change is likely to be significant.

Free transfer exemptions from this requirement have, therefore, been given to holdings of less than 5%, mutual fund companies and companies listed on an acceptable stock exchange.

The task of maintaining the central register of beneficial ownership rests with the BMA.

The BMA has issued details on the disclosure it requires on the beneficial ownership of companies.

The BMA undertakes checks upon proposed beneficial owners to identify potentially unsuitable persons. As a result of this, a number of applications are refused each year.

This approach means that, with the exception of where a free transfer exemption has been granted, the BMA is aware of the beneficial ownership of all companies incorporated in or registered as a foreign company in Bermuda.

9.3.9 **Bearer shares**

Bermuda company law does not permit bearer shares, therefore, Bermuda companies cannot issue bearer shares.

Where foreign companies from jurisdictions which permit bearer shares are admitted the company is required to seek the permission of the Minister of Finance before issuing bearer shares itself. We have been informed that it has been the policy of the Minister to not give permission to permit companies for the issue of bearer shares.

9.3.10 **Insolvency**

Bermuda's insolvency laws are based on the winding up provisions of the United Kingdom Companies Act 1948 and is comprised of the Companies Act 1981 (Part XIII) and the Companies ("Winding Up") Rules 1982.

Insolvency legislation currently in force does not contain the protection for creditors and shareholders that one would expect to find in modern insolvency legislation (e.g. wrongful trading).

9.4 Issues and recommendations

9.4.1 Introduction

The Bermudian system of notification and vetting of proposed beneficial ownership puts it at the highest level of compliance with good practice in this area, as it substantially exceeds the minimum requirement that the beneficial owner of a company can be identified.

Furthermore in a wide range of other areas relating to companies Bermuda meets the requirements of good practice. Nevertheless, as is the case in any system, some enhancements are still necessary and these are detailed in the relevant sections below.

As stated in the Guidance Notes, a review of company law as a whole is beyond the scope of this review. In the circumstances, our specific recommendations should not be considered to be exhaustive.

9.4.2 Publicly traded companies

The preamble to the OECD Principles states that "The Principles focus on publicly traded companies". Similarly, we consider that the G22 report and IMF guide are primarily focused on publicly traded companies.

The Companies Act places additional requirements on those companies whose shares are to be offered to the public. These companies should, under international standards be subject to the OECD Principles, together with the G22 and IMF standards.

In our opinion two views can be taken of this, the first is that the duty should fall upon an exchange and the exchange should not list a company from a jurisdiction whose companies legislation fails to meet the OECD Principles. A second argument is that a jurisdiction that permits its companies to be publicly traded should ensure that its legal framework (taking the legislation and case law together) fully meets the Principles.

In our opinion, a jurisdiction should not rely on exchanges in other jurisdictions to "police" the principles on its behalf. In our view, good practice dictates that a jurisdiction that permits its companies to be publicly traded should ensure that its legal framework complies with the OECD Principles. We consider that the same standards should apply where the shares of a company can be offered for sale to the public, even if those shares are not publicly traded.

Furthermore the recommendations of the G22 Working Group on transparency and accountability include that "national standards for the private sector disclosures reflect five basic elements; timeliness, completeness, consistency, risk management and audit and control processes.

In the circumstances, we consider that companies, registered under the Companies Act, which issue their shares to the public should be subject to a legal framework that meets the Principles.

9.4.3 Private companies

The preamble to the OECD Principles states that the Principles "to the extent that they are deemed applicable ... might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises".

In respect of non-publicly traded companies we have assessed those aspects of the Principles that it is reasonable to apply.

We consider that the sections of the Principles that should, in the most part, apply to private companies are:

- The rights of shareholders (Section I);
- The equitable treatment of shareholders (Section II); and
- The responsibilities of the Board (Section V).

9.4.4 **Audit**

9.4.4.1 ***Audit of public companies and publicly traded companies***

We consider that all public and publicly traded companies should, in line with OECD Principles, be required to prepare and submit annual audited accounts to the Registrar. Bermuda is in line with the former but not fully with the latter requirement. This is because Bermuda only requires companies listed on the Bermuda Stock Exchange and those which continue to offer their shares to the public to file audited statements.

Furthermore, their accounts should be prepared in accordance with International Accounting Standards or an equivalent. Bermuda is in compliance with this requirement.

9.4.4.2 ***Audit of private companies***

We do not consider that, unless it is a regulated institution, a private company should be required to prepare and submit audited accounts as the cost and burden of such a requirement would outweigh the benefits.

We consider that it is open to the shareholders in a company which is other than a public company to require the accounts of the company to be audited. We consider it appropriate that the choice should be for the shareholders to make. Similarly it is a matter for potential creditors and others who do business with such companies to determine whether they wish to require an audit as a condition of entering into a business relationship.

We therefore support the continued practice in Bermuda that non-publicly traded companies should be required to prepare (unless waived in accordance with the provisions of the Companies Act 1981 as amended) but not submit audited accounts as the administrative burden of such a requirement would outweigh the benefit.

We consider that the current practice exceeds the minimum expected for good practice.

9.4.5 **Beneficial ownership**

The existence of a central register of beneficial ownership of companies is, without doubt, a representation of good practice in this area. Furthermore the existence of a vetting process to help prevent ownership by undesirable persons adds further to this as does the requirement that an applicant to form a company signs a declaration that the information provided is true.

It should be noted, however, that the effectiveness of these checks depend upon the accuracy of the information relating to beneficial ownership supplied to the BMA. This is dependent upon industry practice of obtaining confirmation of beneficial ownership as there is no legislative or regulatory requirement. Whilst there is no evidence that this practice is not being followed, there is the possibility of persons providing false names, therefore verification of identity is needed. If this does occur there is no regulatory requirement available to require compliance.

Assurance of identity can be achieved through the client identity verification procedures which should be in operation under the anti-money laundering regulations or via the regulation of those engaged in the provision of certain services to companies. This will ensure that identity checks of beneficial owners are made by the service provider incorporating the company prior to the beneficial ownership details being submitted to the BMA.

Whilst there is already a legal obligation for companies to seek consent under the Exchange Control Act we consider that, to maximise the robustness of the identification system, an obligation could also be placed upon those company service providers who provide registered office services to identify changes in the beneficial ownership of shares registered, unless the free transfer exemption applies, as this may occur without a change in the registered shareholder. This information would then be forwarded to the BMA.

Recommendations in respect of this are contained in the next Section to this Report.

9.4.6 **Directors**

We consider that, whilst Bermuda is substantially in compliance with the OECD Principles in this area, a number of steps need to be taken to enhance this compliance.

Firstly, provision should be made in legislation for the disqualification by the Court of directors who are not fit to be involved in the management of a company. This will reduce the risk of so called "nominee" directors, as a director can be held accountable for a failure to fulfil his duties.

Additionally, in Bermuda there is no regulation relating to the provision of company services including the provision of directors. Therefore, unless such regulation is introduced, there is no vetting of suitability. We therefore recommend, that, as with beneficial owners there should be a requirement for a company to file details of its directors and that they should be subject to a similar vetting process.

We also consider that, in the absence of a regulatory structure, a code of conduct for directors should be developed and given statutory force.

We also consider that the names of directors should form part of the publicly available information held on the companies registry. This would permit transparency as the directors of companies would become a matter of public record.

This approach would also be in accordance with the OECD Principles of Corporate Governance, Section iv, "disclosure and transparency".

9.4.7 **Insolvency**

We consider that the insolvency and winding up provisions in the CIA are inadequate as they do not contain many of the features that we would expect to see in a modern piece of insolvency legislation. Areas in which we consider that the insolvency provisions are inadequate include the following:

- there are no rescue procedures, such as the administration and company and individual voluntary arrangement provision, in the UK Insolvency Act 1986;
- there are inadequate provisions for the avoidance of pre-liquidation transactions, such as those made at an undervalue; and
- the cross-border insolvency provisions are inadequate.

Consequently, we consider that the provisions in place for dealing with insolvent companies are inadequate. We note however that Bermuda propose to update their insolvency laws.

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10 Company service providers

10.1 Introduction

Company management business typically encompasses a number of activities, including:

- the formation of companies for clients;
- the provision of the registered office for companies;
- the provision of registered agents for companies (in those jurisdictions the legislation of which provides for registered agents);
- the provision of nominee shareholders;
- the provision of director services; and
- the preparation and filing of statutory forms for companies.

In this Report we refer to those who undertake company management business as company service providers ("CSPs").

Most of the OTs have legislation which provides for the regulation of CSPs, although not necessarily covering all the above activities.

There are no international standards concerning the regulation and supervision of CSPs, a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either onshore or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of CSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide company services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed CSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the court to wind-up a CSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a CSP's licence, as well as to pursue civil and criminal sanctions;
- CSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the directors of and the shareholders in a company serviced by a CSP and the beneficial owners of the shares in such a company; and
- CSPs, when providing director services, should be required to fulfil their responsibilities as directors and should not be permitted to abrogate their responsibilities through, for example, the use of general powers of attorney.

As indicated in the section on companies, the most practical and effective way of deterring the abuse of company structures and ensuring that relevant information is available to law enforcement authorities is through the regulation of CSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of CSPs in Bermuda and our recommendations concerning enhancements are set out below.

10.2 Type and scale of activity

There is no legislation in place directly regulating the provision of company services.

The main company service providers are law firms, or management companies owned by law firms. This is because of the restrictions under the Bermuda Bar Act on who may prepare memoranda of association. We have been advised that 90% of company applications emanate from Bermuda's two largest law firms.

We further understand that it is primarily these firms and accountancy firms who provide registered office and other company services for the 2,473 active local companies and 10,503 active exempted companies on Bermuda's companies register.

10.3 **Factual assessment**

10.3.1 **Legislation**

Under the Bermuda Bar Act only lawyers or accountants are permitted to make applications to prepare memoranda of association for remuneration. In practice this results in the commercial provision of company formation services being restricted to these professions.

Additionally, under the Companies Act 1981 all local Bermuda companies must have a minimum number of directors/officers resident in Bermuda.

Exempted companies, instead of having a director resident on the Island, may have a secretary and a "resident representative". In the case of a company listed on an appointed stock exchange, only a resident representative is required.

These requirements mean that there is a person within the jurisdiction who should be aware of the activities of the company, so overcoming the problem of some other offshore financial centres where there is no one present in the jurisdiction with this capability.

There is, however, no legislation directly providing for the regulation and supervision of those (predominately lawyers and accountants) providing the following services:

- the registration of companies;
- the provision of registered office services;
- the provision of directors or officers;
- the provision of registered representatives; and
- the provision of nominee shareholders.

10.3.2 **Rules, regulations and guidance notes**

There are no rules or regulations in place concerning the provision of company administrative or management services.

No guidance notes have been issued to company officers or the resident representative concerning their duties.

10.3.3 **Supervision and enforcement - systems and procedures**

Beyond those provided by the Rules of the Bar Association there is no supervision or enforcement with respect to this activity.

Whilst both lawyers and accountants are the subject of professional codes these do not specifically cover this area.

10.4 **Issues and recommendations**

10.4.1 **Introduction**

Bermuda operates a very conservative policy in respect of company formation. This is evidenced both by the requirement to notify the BMA of the proposed beneficial owners of companies and by the restriction on those who can form companies.

In general, we consider Bermuda's approach to this area to represent good practice, ahead of many onshore and offshore centres.

Nevertheless, we consider that there are certain weaknesses to the Bermuda model which need to be addressed in order for the system to be fully robust against abuse and to meet the aims of the Guidance Notes. These are detailed below.

In reaching these recommendations we have taken cognisance of the current structure in Bermuda and have, where possible, sought to enhance that structure rather than replace it.

10.4.2 **Company formation**

Given the restriction on those who can form companies in Bermuda, to lawyers and accountants, both of whom are subject to professional codes and disciplinary action, the good practice requirements on the fit and proper nature of those engaged in this activity are met.

Nevertheless, some Bermudian incorporated companies have been used for illegal activities in other jurisdictions. Similarly, there is a need for formal "know your customer" requirements to be in place for those who form companies in order to protect Bermuda companies against money laundering.

Therefore, we consider that it would be appropriate for requirements to be developed covering the due diligence process on proposed company formations, particularly concerning "know your customer". This latter point is of critical importance given the reliance placed by the BMA upon the accuracy of the beneficial owner information when it undertakes its checks.

We therefore recommend, that the formation of companies should be covered by the anti-money laundering regulations which set out the necessary know your customer requirements.

Compliance with these regulations should also be independently verified.

10.4.3 **Company service provision**

Whilst company service activities are primarily undertaken by legal and accountancy firms there is no statutory restriction on others providing registered office, resident representative directors or nominee shareholder services.

We consider, that these activities should be brought within the ambit of the anti-money laundering regulations to impose a "know your customer" obligation.

10.4.4 **Regulatory development**

Given the existing conservative approach taken to company management in Bermuda we consider that whilst the introduction of a separate regulatory regime for CSPs may be desirable, it is not essential to achieve the objectives of the Guidance Notes.

However, if Bermuda chooses not to create a regulatory structure for CSPs it must, as a minimum, bring company service provision (including formation) within the scope of the Proceeds of Crime (Money Laundering) Regulations. Furthermore, those firms which provide these services must be subject to independent review to verify compliance with the regulations.

Additionally, the risk of abuse of powers of attorney must be addressed. Such powers can be misused to delegate full authority to a third party who could then effectively operate a company whilst remaining unknown to the authorities. If a regulatory regime is not to be introduced the Companies Act should be amended to prescribe the use of powers of attorney so reducing the risk of abuse.

Finally, the lack of a regulatory regime for those who provide directors means that there is no one with initial responsibility to assess the suitability of the director. The BMA should therefore conduct the same checks on proposed directors as they currently do on beneficial owners. This is covered in a previous section to this Report. This check should also cover resident representatives. Furthermore there should also be guidance issued to resident representatives clearly setting out their duties.

Overall, we consider that lawyers and accountants should be subject to an enforceable Code of Practice in respect of the provision of company services. To the extent that this is not presently achieved by lawyers and accountants own professional codes, we consider that these codes should be amended or a new code introduced. The Code of Practice should include requirements relating to:

- knowing the beneficial owner of a company on an ongoing basis;
- the maintenance of records in the jurisdiction;

- the suitability and conduct of directors provided;
- the provision of powers of attorney;
- the segregation of client money and assets; and
- the provision of signing authorities to other persons, including shareholders and the beneficial owners of shares, to a bank account of a company where the licence holder provides director services.

The relevant professional bodies should also ensure that this code is being complied with.

We welcome your comments on this site. *Prepared 27 October 2000*

11 Partnerships

11.1 Introduction

The legislation in all of the OTs provides for two different types of partnership, ordinary or general partnerships and limited partnerships. None of the OTs have legislation in place that provides for the formation of limited liability partnerships (i.e. partnerships which are separate legal entities where, unlike limited partnerships, the limited partners are permitted to take part in the management of the business which and are primarily used as vehicles for professional firms).

11.1.1 Ordinary partnerships

The ordinary partnership legislation of those OTs that have it is based upon the UK Partnership Act. Neither the UK Partnership Act nor the OT partnership legislation establishes supervisory regimes. The legislation typically sets out the rules for determining the existence of a partnership and governs, to a limited extent, the relationship between partners and between the partnership and third parties. Ordinary partnerships are not subject to registration in any of the OTs. The liability of all partners in an ordinary partnership is unlimited.

Ordinary partnerships are formed almost exclusively by domestic businesses in the OTs usually where the business is small or where the members of a particular profession are prohibited from carrying on business through a limited liability company.

As ordinary partnerships are not generally used for offshore purposes, we do not consider that they fall within our TOR and we have not covered them in our review. In so far as ordinary partnership, such as lawyers and accountants, also act as company service providers their role is dealt with in those sections of this Report.

11.1.2 Limited partnerships

Limited partnerships enable the liabilities of "sleeping partners" to be limited to their capital contribution provided that they do not take part in the management of the partnership. They are used typically in investment schemes to limit the liability of investors without giving them ownership of a share in a company. They are also used in estate planning schemes.

The TOR and the Guidance Notes require us to determine whether the legislation, framework and systems in place in each OT conform to good practice having regard, in particular, to FATF and CFATF Recommendations, the OECD Principles of Corporate Governance ("the OECD Principles") and the G22 Report on Transparency and Accountability.

There are no international standards that relate specifically to the supervision of limited partnerships. We have therefore considered the appropriateness of the above general standards for limited partnerships. It is our view that:

- the FATF and CFATF Recommendations that are of primary relevance to limited partnerships are those that concern "know your customer" and record keeping procedures;
- the OECD Principles are designed primarily for publicly traded corporations and are not appropriate to limited partnerships; and
- the G22 Report on Transparency and Accountability is not applicable to limited partnerships.

Due to the limited liability given to limited partners, limited partnerships are attractive offshore vehicles and, in common with all offshore vehicles, are subject to potential abuse by money launderers and other criminals. We therefore consider that good practice requires that, in the event that a limited partnership is suspected of being involved in criminal activity, the law enforcement authorities should be able to access information concerning both the limited and general partners. This approach was envisaged by the Guidance Notes.

We also consider that the business of:

- forming limited partnerships;
- providing a registered office for limited partnerships; and

- acting as a registered agent or registered representative (where applicable)

should be regarded as financial services. As such, it is important that high standards are maintained for the protection of clients. Subject to special circumstances, we consider that good practice standards require that these activities should be regulated.

11.2 **Type and scale of activity**

There are two types of partnership provided for under Bermuda law, ordinary partnerships and limited partnerships. A partnership of either type may be registered as an exempted partnership if one or more partners is a non-Bermudian.

A partnership formed under the law of a jurisdiction other than Bermuda may not carry on business in Bermuda unless it is registered as an overseas partnership.

As at 31st December 1999, the following number of partnerships were registered in Bermuda:

- Exempted partnerships: 379
- Overseas partnerships: 28

No statistics were provided on the type of business carried on by partnerships in Bermuda.

11.3 **Factual assessment**

11.3.1 **Legislation**

Bermuda has four pieces of legislation concerning partnerships. These are:

- the Partnership Act 1902;
- the Limited Partnership Act 1883;
- the Exempted Partnerships Act 1992; and
- the Overseas Partnerships Act 1995.

11.3.1.1 ***The Partnership Act***

For the reasons set out in the Introduction, we have not considered the Partnership Act in this review.

11.3.1.2 ***The Limited Partnership Act ("LPA")***

The LPA permits the formation of limited partnerships and their registration by the Registrar of Companies ("the Registrar"). Limited partnerships consist of one or more general partners and one or more limited partners. The general partners carry on the business of the partnership and have the same liabilities and responsibilities as partners in an ordinary partnership. Limited partners contribute or undertake to contribute capital to the partnership and their liability is limited to the capital that they have contributed or undertaken to contribute. A limited partner is not permitted to take part in the management of a limited partnership. To the extent that he does, he is liable as a general partner.

A limited partnership must have a registered office and a resident representative in Bermuda.

11.3.1.3 ***The Exempted Partnerships Act ("EPA")***

Where one or more partners in a partnership, whether ordinary or limited, is not a Bermudian or a Bermuda company, the partnership may be registered by the Registrar as an exempted partnership. We note that:

- there is no requirement for an exempted partnership to have any Bermudian partners; and a partnership with one or more non-Bermudian partners is not required to be registered as an exempted partnership.

An exempted partnership may be an ordinary or a limited partnership.

An exempted partnership:

- must have a registered office and a resident representative in Bermuda; and
- may not generally hold land in Bermuda or, subject to certain exceptions, carry on any business in Bermuda.

11.3.1.4 ***The Overseas Partnerships Act ("OPA")***

A partnership formed under a law other than the law of Bermuda is an overseas partnership and must not carry on any trade or business in Bermuda unless registered by the Registrar under the OPA.

An overseas partnership may consist of Bermudian and/or non-Bermudian partners and may be an ordinary partnership or a limited partnership. Except as provided by the OPA, an overseas partnership is governed by the law of the jurisdiction under whose law it was formed.

An overseas partnership must have a registered office and a resident representative in Bermuda.

We have been advised by the Bermuda Government that overseas partnerships are required to give reasons for wishing to apply to be registered in Bermuda and that these reasons are carefully considered before permission is granted.

11.3.2 **Regulations, rules and guidance notes**

There are no rules, regulations or guidance notes concerning partnerships apart from one issued by the BMA detailing the procedure for forming a partnership and outlining the relevant Bermuda legislation.

11.3.3 **The formation and registration of limited, exempted and overseas partnerships**

Persons who carry on the business of forming limited, exempted or overseas partnerships, providing the registered office for and acting as the resident representative of such partnerships are not, in that capacity, regulated or subject to the Proceeds of Crime (Money Laundering) Regulations 1998. They are not, therefore, subject to the requirements contained in those regulations concerning know your customer or record keeping procedures.

However, we have been advised by the Bermuda Government that the registered offices of most limited, exempted and overseas partnerships are provided by lawyers or regulated institutions, such as banks.

The registration process for limited, exempted and overseas partnerships is broadly similar and can be summarised as follows:

- intention to form the partnership must first be advertised;
- details of all partners must be provided to the BMA which vets the general partners;
- the consent of the Minister of Finance to form the partnership must be obtained;
- if the Minister gives his consent, the partnership is registered by the Registrar; and
- Limited partnerships must have a capital of at least B$12,000.

11.3.4 **Supervision - systems and procedures**

11.3.4.1 ***Regulatory structure***

Details of the structure and resources of the Registrar and Companies Registry are provided in the section of this Report on Companies.

11.3.4.2 ***On-going supervision***

In common with other jurisdictions, there is no on-going supervision of limited, exempted and overseas partnerships.

11.3.5 **Enforcement — systems and procedures**

The following enforcement procedures are available in respect of limited, exempted and overseas partnerships:

- where the consent of the Minister to certain changes in particulars is not obtained, he may apply to the Court for the dissolution of the partnership;

- the Minister may appoint an inspector in respect of an exempted or an overseas partnership, but not a limited partnership; and
- certain breaches of the Acts constitute offences and are punishable by a fine.

11.3.6 **Publicly available information**

11.3.6.1 ***Information held by the Registrar***

The information contained in the registers of limited, exempted and overseas partnerships maintained by the Registrar covers the following:

- in the case of a limited partnership, the names and places of residence of the general partners;
- in the case of an ordinary partnership (exempted or overseas), the names of the partners and, in the case of an overseas partnership, the addresses of the partners;
- in the case of an exempted or overseas partnership, the name of the resident representative and his address if different to that of the registered office;
- the general nature of the partnership business;
- the address, in Bermuda, of the registered office of the limited partnership;
- the date when the limited partnership is to commence and the term, if any;
- the date and amount of each capital contribution made or undertaken to be made by a limited partner; and
- in the case of an overseas partnership, the law governing the partnership and the address, outside Bermuda, of the principal place of business of the partnership.

Limited partnerships, exempted partnerships and overseas partnerships are required:

- to advertise and obtain the consent of the Minister to any change in (i) the name of the partnership; (ii) the general partners; (iii) the general nature of the partnership business; and (iv) the resident representative, in the case of an exempted or overseas partnership;
- to notify the Registrar of any change in registered particulars; and
- to send to the Registrar an annual declaration stating the general nature of the partnership business.

The registers are all available to the general public.

11.3.6.2 ***Information held at the registered office***

The general partners of a limited partnership are required to keep a register of limited partners at the registered office which must contain the following:

- the name and address of each limited partner;
- the date upon which a person becomes or ceases to be a limited partner; and
- the amount of cash contributed or undertaken to be contributed by each limited partner as capital, together with the value of any non-cash contribution.

The register of limited partners required to be kept by the general partners of a limited partnership is open to public inspection.

11.3.7 **Non-public information**

An exempted partnership and an overseas partnership, whether limited or ordinary, must keep at its registered office, as a minimum, sufficient records of account to enable the financial position of the partnership at the end of each three month period to be ascertained.

11.4 Issues and recommendations

11.4.1 Introduction

In accordance with our interpretation of our TOR, we are required to assess whether:

- in the event that a limited partnership is used or suspected of being used for criminal purposes, the law enforcement authorities in Bermuda are able to obtain basic information concerning the partnership, such as the identity of the partners;
- the identity of general and limited partners of limited partnerships in Bermuda has been ascertained through the usual "know your customer" procedures; and
- adequate procedures are in place to protect the interests of partnerships utilising professional service providers in Bermuda.

For the reasons set out in the following paragraphs we are of the view that, with some minor exceptions, the legislation and systems in place in Bermuda concerning limited partnerships exceed good practice standards.

We do consider that some further enforcements may be desirable and these are set out below.

11.4.1.1 *Availability of information to law enforcement agencies*

As set out above, a significant amount of information is required to be filed with the Registrar. This information is available to the public and therefore readily accessible to the law enforcement authorities in Bermuda.

Furthermore, a limited partnership is required to keep at its registered office in Bermuda such records of account as would enable the financial position of the partnership at the end of each three month period to be ascertained. Although these records are not available to the public, subject to Court Order, they could be accessed by the law enforcement agencies if required.

We are of the opinion that the legislative requirements prescribing the information and records to be kept in Bermuda are comprehensive and exceed good practice standards. Of course the quality of the information will be dependent upon:

- the due diligence checks undertaken with regard to partners; and
- the degree of compliance with regard to the other record keeping requirements.

These matters are addressed in the following paragraphs.

11.4.1.2 *Application of know your customer and record keeping requirements*

The BMA carries out the same due diligence checks on general partners as it carries out on the shareholders of companies. We have commented on enhancements that could be made to the vetting procedure in the Companies section of this report. We consider, however, that the carrying out of such checks exceeds good practice standards.

We do not, however, consider that the vetting checks undertaken by the BMA should be considered as a substitute for the due diligence checks that FATF and CFATF Recommendations require to be undertaken by professional service providers.

Persons who form limited partnerships or provide registered office or resident representative services for limited partnerships are not currently subject to any "know your customer" or record keeping requirements. We consider that in order to comply with FATF and CFATF Recommendations they should be. In the circumstances, we recommend that all persons who, for profit, form limited partnerships or provide registered office or resident representative services for limited partnerships should be subject to the Proceeds of Crime (Money Laundering) Regulations 1998 in respect of that activity.

11.4.1.3 *Regulation of professional service providers*

We have indicated that those who form limited partnerships and those who provide registered office and resident representative services for limited partnerships should be considered as financial service providers. We consider that, generally such service providers should be regulated. The objectives of regulation are as follows:

- the maintenance of standards generally that will protect partnerships using the service providers; and

- the maintenance of high record keeping standards so that records required to be kept at the registered office are maintained in good form so that they are of value to the law enforcement agencies, if required.

We consider that the due diligence undertaken by the BMA on general partners and the fact that the majority of service providers are either lawyers or other regulated institutions may achieve the results sought by regulation and that to require regulation of the service providers by the BMA may not add any value, despite the additional regulatory overheads.

We consider, however, that to avoid the necessity for the introduction of a scheme for the regulation of partnership service providers:

- Bermuda must ensure that all partnership service providers are subject to the Proceeds of Crime (Money Laundering) Regulations 1998 as recommended above;
- that only lawyers or other regulated entities should be permitted to provide partnership services; and
- that all limited partnerships should be required to utilise a lawyer or other regulated entity to provide its registered office and its resident representative.

11.4.1.4 ***Exempted and overseas partnerships***

All exempted and overseas partnerships (even where they are ordinary partnerships) are subject to similar registration and other procedures as limited partnerships. We consider that this accords with good practice as these partnerships have an offshore connection. Our recommendations concerning limited partnerships also apply to exempted and overseas partnerships that are ordinary partnerships.

11.4.1.5 ***Other areas for improvement***

There is no provision for the appointment of an inspector of a limited partnership. We consider that it should, in suitable circumstances (for example on the public interest ground), be possible for the Court to appoint an Inspector of a limited partnership and for the Inspector to have powers of dissolution.

As indicated earlier, partnerships having non-Bermudian partners may register but are not required to register as exempted partnerships. As a result, there is no vetting by the BMA of the partners of such partnerships unless they are limited partnerships. The Ministry of Finance considers that a non-Bermudian cannot be a partner in an ordinary partnership without becoming subject to the Immigration Act and that control is therefore retained. However, it must be accepted that in such cases non-Bermudian partners will still fall outside the BMA vetting procedures. We consider that it would be better for all non-Bermudian partners to be vetted by the BMA.

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12 Trusts

12.1 Introduction

Trusts are commonly used in offshore structures. They typically involve settlors, trustees and beneficiaries and often involve protectors, enforcers and custodians.

The settlor of a trust[2] is the person who transfers ownership of his 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.

The trustees of a trust hold legal title to the trust property. They must keep trust property separate from their own property. 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 invite and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes.

All trusts (other than purpose trusts) must have beneficiaries who may include the settlor. The trustees must account to the beneficiaries for what they do with the trust property. The beneficiaries are entitled to enforce implementation of the trust deed. A trust may be settled without existing beneficiaries provided that a beneficiary is or beneficiaries are ultimately ascertainable.

A trust may have a protector who will typically have powers to veto the trustees' proposals or remove them. A purpose trust is a trust for a particular purpose or purposes. Most of the OTs permit charitable and non-charitable purpose trusts.

An enforcer is the person who has the power to enforce a purpose trust.

A custodian trustee holds the trust property to the order of the managing trustee.

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the Terms of Reference (TOR). The TOR, therefore, require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for the criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries, protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary, because a proper consideration of the above issues involve both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the UK Home Office "Review of Financial Regulation in the Crown Dependencies" (Section 12.9.5). Our recommendations concerning professional trust providers in Bermuda are contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of Bermuda are required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not, in this Report, concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

12.2 Type and scale of activity in Bermuda

There are no requirements for trusts to be registered or reported in Bermuda.

The BMA considers that it is has a general understanding of the type and scale of the trust business in Bermuda from its regular prudential meetings with licensed trust companies, although there are no definitive statistics available concerning the number or the net value of trusts administered in Bermuda. There is believed to be substantial trust activity on the Island.

From our discussions with the BMA and representatives of the private sector, it appears that the trust business undertaken in Bermuda has the following characteristics:

- well over half of the trusts established in Bermuda are individual or personal trusts established for wealthy individuals and families, the balance of the business being for corporate clients, frequently as part of a corporate financing structure;
- due to the conservative nature of the legislation, asset or creditor protection trusts are not widely used; and
- the offshore client base is drawn principally from the US, Canada and Europe.

Although the legislation allows for non-charitable purpose trusts, the extent to which these are used is not clear.

12.3 Factual assessment

12.3.1 Legislation

The principal legislation relating to trusts in Bermuda is:

- the Trustee Act 1975 (last amended in 1999);
- the Trusts (Special Provisions) Act 1989 (last amended in 1998);
- the Perpetuities and Accumulations Act 1989;
- the Conveyancing Amendment Act 1994; and
- the Charities Act 1978.

12.3.1.1 *The Trustee Act 1975 ("TA")*

The TA makes general provision for trusts in Bermuda and provides for the duties and powers of trustees.

Although there are differences, the TA is broadly equivalent to the English Trustee Act 1925.

12.3.1.2 *The Trusts (Special Provisions) Act 1989 ("TSPA")*

The TSPA covers conflict of law issues that may arise in relation to the recognition of trusts and enables the establishment of purpose trusts.

At least one of the trustees of a purpose trust must be a designated person (essentially a barrister or attorney, a chartered accountant or a trust corporation) and a purpose trust must have an enforcer. The designated person is required to keep certain trust records in Bermuda.

In respect of conflict of law issues, the legislation closely follows The Hague Convention on trusts.

12.3.1.3 *The Perpetuities and Accumulations Act 1989 ("PAA")*

The PAA is broadly equivalent to the English Perpetuities and Accumulations Act 1964. Unlike the English Act, however,

the PAA does not limit the accumulation period to 21 years but allows for the income to be accumulated during the trust period up to a maximum of one hundred years.

12.3.1.4 ***The Conveyancing Amendment Act 1994 ("CAA")***

The CAA amend the Conveyancing Act and establishes the framework for asset or creditor protection trusts.

We note that the CAA provides:

- a six year period within which a creditor can seek to void a disposition at an undervalue; and
- that a person who becomes a creditor within two years after the disposition date may apply to void a disposition at an undervalue.

12.3.1.5 ***The Charities Act 1978***

The Charities Act governs charitable trusts.

12.3.2 **Regulations, rules and guidance notes**

There are no relevant regulations, rules or guidance notes relating to trusts.

12.3.3 **Supervision and enforcement - systems and procedures**

Trusts are not registrable in Bermuda and, in common with other jurisdictions, are not subject to regulation by a regulatory authority. There is, therefore, no requirement for trustees, beneficiaries, custodians or protectors of Bermuda trusts to be notified to any central authority.

Trustees do, however, have a number of duties imposed on them under the TA and duties imposed on a trustee under English common law would almost certainly be imposed on trustees by the courts in Bermuda.

12.4 **Issues and recommendations**

12.4.1 **Introduction**

Trust legislation in Bermuda is similar to the trust legislation in a number of other jurisdictions, including England. In general, we do not consider that there are any particular features of the TA that are likely to lead to trust structures in Bermuda being any more or less attractive to criminals or money launderers than trusts in other jurisdictions.

In respect of asset or creditor protection trusts and purpose trusts, we consider that Bermuda exceeds good practice standards set out in the Guidance Notes by comparison with other offshore jurisdictions.

12.4.2 **Preventing the abuse of trusts**

As indicated in the Introduction to this section, we consider that the most practical and effective way to prevent the abuse of trusts is through the regulation of trust service providers. We consider that all persons providing trust services should be regulated. Our recommendations concerning this are set out in the next section. We do not consider that any changes to the TA are required to support this.

We are concerned, however, that the use of purpose trusts may be open to abuse. Purpose trusts have no beneficiaries to take action against trustees who are in breach of their duties and there is therefore, a possibility of abuse by the trustees.

The TSPA provides, however that:

- all purpose trusts must have an enforcer;
- at least one of the trustees of a purpose trust must be a designated person (ie a professional);
- the designated person must keep certain trust documents in Bermuda.

We consider that the protections contained in the TSPA exceed good practice standards and that they will substantially reduce the risk of the abuse of purpose trusts.

12.4.3 **Establishing the true owner of trust assets**

In general, the beneficial ownership of assets held in an express trust may be clear and ascertainable. However, this may not necessarily be the case for a discretionary or purpose trust or where the trustees may exercise discretionary powers of appointment.

We consider that, in the case of trusts administered by a professional trust service provider, law enforcement and regulatory authorities must, in appropriate circumstances, be able to identify the settlor, trustees, beneficiaries, protector and custodian and have access to the trust instrument and other relevant documentation concerning the trust.

This requires that the relevant documentation and information is kept within the jurisdiction. In respect of trust service providers, this is covered in the next section. This is not a general trust issue and we do not, therefore, consider that the TA requires any amendment in this respect.

12.4.4 **Transparency of financial arrangements**

The Guidance Notes indicate:

- that basic financial information relevant to the activities of trusts should be available to law enforcement and regulatory authorities; and
- that trustees should, ideally, be held accountable to beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector, where applicable.

We are further asked to consider in what circumstances it would be appropriate for accounts to be produced, whether accounts should be made public, in which circumstances abbreviated accounts might be acceptable and in which circumstances the requirement to produce accounts should not be applied.

We consider that professional trust service providers should be required to maintain proper financial records and that these should be available for inspection by the protector and beneficiaries (where appropriate). We also consider that these records should be available to law enforcement authorities where required in a criminal investigation. Our recommendations concerning this are contained in the next section of this Report.

However, we consider that requiring the preparation of accounts and their subsequent audit may be regarded by some clients as an unnecessary cost burden. In our view, it should be for the client to determine whether he wishes accounts to be prepared and audited. It is not the role of legislation to impose it. Nevertheless, we believe that the preparation and where appropriate, auditing of trust accounts, is of benefit as it reduces the risk of mis-appropriation of trust assets.

12.4.5 **Removal of impediments to asset tracing and seizure**

This is considered further in the section on Money Laundering.

There is nothing in the legislation to prevent a "flee" clause being included in a trust deed, the effect of which may be to frustrate the seizure of assets emanating from a criminal source.

We therefore recommend that as flee clauses are an issue of general application, trust legislation should be amended to restrict their use.

12.4.6 **Asset or creditor protection trusts**

The Guidance Notes also require us to consider whether the claims of creditors in the OTs can be defeated through trust structures. The relevant legislation in Bermuda is the CAA which enables the establishment of asset protection trusts.

We consider that in comparison with equivalent legislation in other offshore jurisdictions, the CAA is conservative and exceeds good practice standards.

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2 The descriptions of settlors, trustees, beneficiaries, protectors, enforcers and custodians are based on those set out in the "Review of Financial Regulation in the Crown Dependencies" which we consider provide excellent summaries. Back

13 Trust service providers

13.1 Introduction

There are no international standards concerning the regulation and supervision of trust service providers ("TSPs"), a point recognised by the Terms of Reference (TOR). Indeed, it is significant that few jurisdictions, either on or offshore regulate these activities. The TOR, therefore, require us to assess whether the legislation, framework and arrangements in place for the regulation of TSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

those who provide trust services should be licensed and subject to effective regulation;

- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed TSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the Court to wind up a TSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a TSP's licence, as well as to pursue civil and criminal sanctions;
- TSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the settlor, beneficiaries, protector and the custodian (where applicable) of a trust and to obtain a copy of the trust instrument;
- law enforcement and regulatory authorities should be able to access financial information relevant to the activities of trusts administered by a TSP; and
- trustees should be held accountable to the beneficiaries and settlor, and the protector, where applicable, by preparing regular accounts, where appropriate.

As indicated in the section on trusts, the most practical and effective way of deterring the abuse of trusts and ensuring that relevant information is available to law enforcement authorities is through the regulation of TSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of TSPs in Bermuda and our recommendations concerning enhancements is set out below.

13.2 Type and scale of activity

Every company that carries on trust business "in the service of the public generally" must be licensed under the Trust Companies Act 1991. There are currently 34 licensed trust companies.

The licensed trust companies can be categorised as follows:

Local trust companies owned by law firms	6
Local trust companies owned by accounting firms	4
Local trust companies, other	13
Multi-jurisdictional trust companies headquartered outside Bermuda	10
Multi-jurisdictional trust companies headquartered in Bermuda	1

The BMA does not envisage a significant expansion in the number of licensed trust companies over the next few years.

Most licensed trust companies are members of The Bermuda Association of Licensed Trustees ("BALT"), although membership of BALT is not compulsory.

Individuals and partnerships carrying out trust business are specifically excluded from the Trust Companies Act and not regulated under any other Act. There is no information on the amount of unregulated trust business carried on in Bermuda, but the feeling of both the BMA and the industry is that it is not large.

As indicated above, a trust company the business of which is not "carried on or practised in the service of the public generally" is not required to be licensed under the Act. This has been interpreted by the BMA as excluding private trust companies that are set up to manage a number of related private or family trusts. No information has been provided on the size or nature of the business undertaken by private trust companies.

13.3 **Factual assessment**

13.3.1 **Legislation**

The legislation governing the regulation of trust business is the Trust Companies Act 1991 ("TCA").

The TCA provides for the licensing of companies that carry on trust business which is defined as "the undertaking, executing and administering of trusts, as a business, trade, profession or vocation carried on or practised in the service of the public generally".

There is only one class of trust licence.

Areas covered by the TCA include:

- granting, variation and cancellation of trust company licences;
- minimum capital requirement for licensee (in First Schedule);
- duties of licensee;
- investigation of affairs of a trust company and other enforcement powers;
- winding-up of trust companies; and
- ongoing supervision of licensees.

Under Section 11 of the TCA, a licensed trust company is required to keep its own company accounts segregated from the trust accounts. It is not clear that this section actually obliges a trust company to keep trust accounts.

Under Sections 13 and 14 of the TCA, a licensed trust company is required to prepare financial statements each year and to have them audited.

13.3.2 **Rules and Regulations**

No rules and regulations have been made under the Trust Companies Act. Indeed, the Act does not provide any regulation making powers.

The Proceeds of Crime (Money Laundering) Regulations apply to trust companies and to any other person carrying on trust business.

13.3.3 **Guidance**

Schedule 1 of the Trust Companies Act sets out minimum criteria for a trust company licence and includes a requirement that the company has adequate insurance. The BMA has issued Guidelines on what insurance cover it considers is adequate within the meaning of the Schedule. Broadly, this can be summarised as follows:

(a) fidelity insurance, minimum BD$1,000,000 (required);

(b) trust real property insured to cost of replacement (required);

(c) errors and omissions, minimum BD$1,000,000 (required); and

(d) loss of property, forgery, electronic and computer crime, buildings and office contents, computer damage, business interruption, political risk and directors and officers liability (all desirable).

The BMA has not issued any other general guidance to trust companies.

The Guidance Notes on the Prevention of Money Laundering apply to trust companies.

13.3.4 **Supervision - systems and procedures**

13.3.4.1 ***Regulatory resources***

Day-to-day supervision of trust companies is undertaken by the BMA.

13.3.4.2 ***Application process***

Application for a trust company licence is made to the Minister via the BMA. The licensing process is as follows:

(a) Application is made to the BMA, which undertakes an examination of the application and vets the beneficial owners of the proposed trust company and its intended management.

(b) The BMA undertakes such further enquiries and investigations as it considers necessary and passes the application to the Minister with a recommendation.

(c) The Minister may undertake his own enquiries and will then grant or refuse the licence.

The Minister may not grant a licence to a company unless he is satisfied that the company satisfies the minimum criteria set out in the First Schedule to the TCA. This provides that:

- the objects and powers of the company permit it to carry on trust business;
- the company has a paid up share capital of BD$250,000;
- the company has adequate insurance;
- the company has premises adequate for its business; and
- the company has sufficient personnel with adequate knowledge, skill and experience.

All trust licences we examined were subject to the same conditions, including a condition that the prior permission of the BMA be obtained before any change in beneficial ownership or directors and management (termed "top executive" in the TCA).

Only the Minister can cancel a licence once granted.

13.3.4.3 ***Ongoing supervision***

Regular ongoing supervision of licensed trust companies comprises the following:

(a) Every licensed trust company is required to provide the BMA on an annual basis with

(i) the company's audited financial statements;

(ii) a certificate of management in the form provided in Schedule 2 to the TCA; and

(iii) an approved auditors' report in the form provided in Schedule 3 to the TCA.

(b) The BMA holds a prudential meeting at its offices at least once each year with the senior management of each licensed trust company. These meetings are not specifically provided for by the TCA.

There is no on-site supervision.

13.3.5

Enforcement - systems and procedures

Although the TCA gives the BMA the duty to supervise trust companies, the powers of enforcement are principally vested in the Minister. The main powers of enforcement provided under the TCA are as follows:

(a) Under Section 15 of the TCA, the Minister has the power to appoint an inspector to investigate and report on the affairs of a trust company.

(b) Under Section 16, the BMA has the power to require an officer, employee or agent of a trust company to provide it with information concerning the trust company (although not information relating to a particular trust).

(c) Under Section 17, in certain limited circumstances, an inspector or an officer of the BMA may apply to the Supreme Court for an order that information concerning a particular trust is disclosed.

(d) Under Section 18, the Minister may direct the BMA to petition the Court for the winding-up of a trust company on the grounds that it is in breach of the Act, or a condition of its licence. There is no power for the Minister to apply to the Court under the TCA for the winding-up of a trust company on the public interest ground.

(e) Under Section 19, the Minister may give directions to a trust company where he considers that it is carrying on business in detriment of the public interest, its creditors or members.

(f) Under Section 20, the Minister may on certain grounds cancel a trust company licence.

(g) Under Section 21, the Minister may on certain grounds vary a trust company licence.

13.4 Issues and recommendations

13.4.1 Introduction

Whilst the existence of legislation relating to trust service provision is a further positive feature of Bermuda's regulatory regime and addresses many areas of good practice we agree with the BMA that the current legislation regarding TSPs is not in accordance with the Guidance Notes or good practice. The BMA advise us that it is working on proposals for new legislation which will comply with these standards.

As an integral part of this legislative update the BMA will need to address the joint responsibility for licensing and regulation which currently exists.

A code of practice is required to comply with the principle of "know your client", which should be accompanied by an ability by the BMA to examine client files. This will enable identification of beneficial ownership and aid with international co-operation.

13.4.2 Scope of legislation

The TOR state that those who provide trust services should be licensed and subject to effective regulation. As indicated above, individuals and partnerships and private trust companies are currently excluded from the Trust Companies Act ("TCA") and therefore completely unregulated. The definition of private trust business is unclear and the BMA has never issued any guidance concerning its interpretation of trust services "carried on or practised in the service of the public generally".

It has been suggested to us that lawyers should be exempted because they are covered by their own Code of Conduct. This is discussed below. In respect of other individuals and partnerships, however, we have been provided with, and can see, no justification for excluding them from regulation by the BMA as trust service providers.

We understand that membership of the Bar Association in Bermuda is compulsory and that the Bar has the ability to discipline its members. However:

- we note that the Code of Conduct as currently drafted does not cover trust business;
- even if the Code of Conduct is amended to cover trust business, we consider that it is more appropriate for the BMA to regulate all trust service providers to ensure a consistent approach; and
- the BMA as the primary regulator of trust business should have access to relevant information in respect of all trust business.

In conclusion, therefore, we consider that there are very strong arguments in favour of bringing lawyers under the BMA's regulatory scope in respect of their trust business.

We understand the rationale put forward for excluding trust companies that act in relation to a limited number of connected family trusts. However, the BMA currently has no means of ascertaining the nature or extent of the business carried on by private trust companies and, more importantly, has no powers of enforcement available in respect of private trust companies. Furthermore, by permitting private trust companies to use the word "trust" in their company name, albeit limited by the word "private" we consider that third parties could reasonably hold the view that such a company is regulated.

On balance, we consider that private trust companies should be subject to regulation under the Trust Companies Act. We accept that, provided the BMA retains adequate powers of enforcement, such companies could be subject to a "lighter" regulatory touch (including, possibly, lower capitalisation requirements). We do not see it as our role to draw the line; this is a matter for the BMA to consider further.

We therefore recommend that private trust companies be brought within the scope of the legislation, the aim of which should be to:

- enable the BMA, through returns, to monitor the nature and extent of the business carried on by private trust companies;
- ensure that private trust companies are subject to certain fundamental obligations, for example the segregation of trust accounts; and
- provide the BMA with sufficient enforcement powers.

We recommend that the TCA should be amended to permit the BMA to impose a higher level of capitalisation than the minimum specified.

Finally, we recommend that individuals and partnerships including lawyers carrying on trust service provision (for example acting as trustee) should be regulated. Unlike with the IBA, where exempted persons are not subject to the anti-money laundering regulations, all those doing trust business, whether licensed or not, are already subject to the POC regulations.

13.4.3 **Regulatory supervision**

13.4.3.1 ***Joint responsibility for licensing and regulation***

It is in our view unsatisfactory for the licensing of trust companies and the supervisory powers to vest in different persons or bodies. It is also unsatisfactory that the BMA as the body charged with ongoing supervision is not given the necessary powers of enforcement.

We consequently recommend that the BMA should be made the licensing authority for trust companies and should have all enforcement powers vested in it.

13.4.3.2 ***Application Procedure***

We consider that the Trust Companies Act makes inadequate provision with regard to the application process. The First Schedule sets out minimum criteria for the issue of a licence. Apart from that, the TCA is vague in requiring an application to be accompanied by "such information and documents as the Minister may require" and to be made "in such manner as the Minister may direct". The BMA has issued guidance on what it considers to be adequate insurance but otherwise no forms or formal procedures have been prescribed by the Minister.

Furthermore, essential elements of the application procedure are missing. For example, there is no requirement that the applicant, shareholders, beneficial owners, directors and managers meet the "fit and proper" criteria.

This requirement should also include that all licence holders are subject to "four eyes" control.

We recommend that the TCA should be amended, perhaps to mirror the Bank and Deposit Companies Act, to provide for a robust application process.

13.4.3.3 ***Ongoing supervision, enforcement and restrictions on licensees***

The BMA does not currently undertake regular on-site inspections of licensed trust companies. We consider that, in this respect, ongoing supervision fails to accord with good practice.

We note that the effect of Section 17 of the Trust Companies Act is to prevent the BMA from having access to client files

without a Court Order, which can only be granted if the material sought is, or contains, evidence of drug trafficking or money laundering, stealing or other dishonesty affecting trust property or a contravention of a law pertaining to an international agreement binding on Bermuda. In the circumstances, the BMA will not be able to undertake effective on-site inspections of trust companies as it will not be able to check the business undertaken by the licensee.

In this regard, we consider that the legislation fails to meet good practice standards.

The Trust Companies Act falls short of good practice in a number of other areas. For example:

- there is no obligation to seek the permission of the BMA for a change in beneficial ownership although conditions are currently used to create such obligations;
- there is no power to require a higher level of capitalisation than the minimum;
- there are no regular or triggered reporting requirements;
- the Act contains no regulation making powers;
- the BMA does not have the power to "police the perimeter"; and
- the enforcement powers are inadequate.

Although the auditor of a trust company must provide the BMA with a report as in the form of Schedule 3, we consider that this is not sufficient. We suggest that auditors should be required to sign a much more robust report on compliance with the provisions of the Act and upon certain other prescribed matters.

13.4.3.4 ***Code of practice***

We consider that the most appropriate method of meeting good practice standards set out in the Guidance Notes in respect of knowing the identity of the settlor, beneficiaries, protector and custodian is via the regulation and supervision of the service provider.

To facilitate the meeting of these standards, we consider that the regulatory environment should include an enforceable code of practice.

This code of practice should include requirements relating to:

- knowing the identity of the settlor, protector and custodian on an ongoing basis;
- knowing, where possible, the identity of the beneficiaries;
- verifying, so far as is possible, the source of trust assets to ensure they are not of illegal origin;
- ensuring that those who undertake trust work are appropriately trained and competent;
- the delegation of any services provided, including provision of powers of attorney;
- the conduct of trustees provided by licence holders;
- the segregation of trust money and assets; and
- the maintenance of books and records including a copy of the trust deed and other documents relating to the trust.

Where areas in the code are adequately covered by any anti-money laundering regulations then the code may simply make adherence to those regulations a requirement under the code of practice so providing regulatory enforcement powers.

13.4.4 **Beneficial ownership**

The TOR require us to ascertain the means available to regulators and law enforcement agencies to obtain details of the beneficial ownership of trust assets. We consider that the trust service provider should primarily be concerned with the source of the assets settled into trust. This will require the trust service provider to carry out due diligence to verify the identity of the settlor, protector, custodian and any co-trustees. The trust service provider should keep in Bermuda the following:

- a copy of the trust deed and any memorandum of wishes;
- details of the settlor and the source of all assets settled into the trust;
- the identity of the protector and any custodians and co-trustees;
- the identity of any known beneficiaries;
- minutes of all decisions taken by the trustees; and
- trust accounts or, at the very least, records which would enable trust accounts to be drawn up.

The above will then be available to law enforcement agencies and the regulator in the event of a criminal investigation taking place and will allow Bermuda to comply with international standards.

Requirements concerning this could either be introduced via regulation or form part of the anti-money laundering regulations and guidance notes.

13.4.5 **Good practice guidelines**

The BMA has not issued good practice guidelines to the industry, although BALT is considering adopting the ITCA standards when developed. We are of the opinion that the BMA should consider issuing good practice guidelines following consultation with the industry.

13.4.6 **Capitalisations**

We note that whilst the TCA provides for a minimum level of capital the BMA is not given power, where circumstances justify it to require an applicant or a licensee to maintain a higher level. We recommend that such a power is created.

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14 International co-operation

14.1 Introduction

A number of international standards are in place concerning the provision of co-operation between law enforcement and regulatory authorities. These include those established by international regulatory bodies such as IOSCO, IAIS and Basel, the relevant FATF/CFATF Recommendations, the "Ten Key Principles for International Financial Information Exchange" recommended by the G7 Finance Ministers in May 1998 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. These, together with good practice standards, are referred to in the Guidance Notes. We were not asked to consider international co-operation relating to purely fiscal matters, but we have considered whether the legislation permits co-operation on criminal tax matters.

The principal international standards and good practice standards set out in the TOR and the Guidance Notes are that:

- there are effective gateways in place through which an OT regulator can disclose confidential information obtainable from licensed bodies, including client information, to foreign regulatory authorities;
- the OT regulator is able, through the imposition of conditions, to require that confidential information it discloses to a foreign regulatory authority is not onward disclosed by the foreign regulatory authority without the consent of the OT regulator;
- an OT regulator is able to safeguard the confidentiality of information disclosed to it by a foreign law enforcement or regulatory authority;
- where necessary, MOUs between an OT regulator and foreign regulatory authorities are in place and that MOUs should contain provisions for safeguarding the confidentiality of information provided;
- the law enforcement authority in an OT has a full range of powers to provide mutual legal assistance to foreign law enforcement authorities, including the obtaining of evidence and the provision of assistance at the investigation stage;
- co-operation between law enforcement authorities should cover all financial crimes (including, for example, fraud, insider trading and market manipulation) and not just drugs related offences or money laundering;
- it should be possible for co-operation to be provided, even if the activity under investigation takes place and/or is not a criminal offence in the OT;
- international co-operation should extend to tracing, freezing and confiscating proceeds of crime on behalf of overseas authorities. This should be on an "all crimes" basis (including all financial crimes), as envisaged by the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990;
- no assets should be immune from seizure by virtue of OT laws or through asset protection trusts or flee clauses in trusts;
- law enforcement and regulatory authorities should be able to co-operate effectively with each other both domestically and with their counterparts abroad;
- OT regulators can, in the course of their normal duties, obtain information relating to the supervision of licensees which can be disclosed to foreign regulatory authorities through the statutory gateways;
- OT regulators have powers at least equivalent to those contained in the Model "Compulsory Powers Ordinance" annexed to the Guidance Notes to compel the production of information, at the request of foreign regulatory authorities for their own regulatory purposes, from both regulated and unregulated bodies and persons; and
- adequate resources, including legal advice, are available to OT regulatory and law enforcement authorities for the purposes of international co-operation.

The TOR for this review require us to consider whether the legislation and systems and procedures in place in Bermuda for international co-operation conform to the above international and good practice standards.

Areas for development and action are contained in the issues and recommendations section below.

14.2 Confidentiality

14.2.1 Introduction

Regulators are usually subject to a duty of confidentiality which may be imposed:

- under a general statute that preserves the confidentiality of information with respect to business that is of a professional nature;
- in legislation that creates or governs the regulator;
- in legislation that provides for the regulation of particular financial services activities; and/or
- under common law.

It is appropriate, and in accordance with international standards, for restrictions to be placed upon the disclosure of confidential information by a regulator. However, in order for a regulator to co-operate effectively with foreign regulatory and law enforcement authorities, there must be gateways through which he can pass confidential information.

14.2.2 Relevant Bermuda legislation

There is no general statutory duty of confidentiality under Bermuda law. However, a duty of confidentiality is imposed upon the BMA at common law and in certain statutes concerning the regulation of financial activities.

For the purposes of this Report we have reviewed the following statutes, all of which contain provisions relating to the preservation of confidentiality and to international co-operation generally:

- the Bank and Deposit Companies Act 1999;
- the Insurance Act 1978;
- the Investment Business Act 1998;
- the Bermuda Monetary Authority Act 1969;
- the Companies Act 1987;
- the Proceeds of Crime Act 1997 ("PCA");
- the Criminal Justice (International Co-operation) (Bermuda) Act 1994 ("CJICA"); and
- the USA Bermuda Tax Convention Act 1986 (as amended) ("USBTCA").

14.3 Co-operation between regulatory authorities

14.3.1 Legislative gateways

14.3.1.1 *BMA Act*

The BMA Act contains broad confidentiality provisions. Section 31 provides that any director, officer, servant, agent or adviser of the BMA must preserve the secrecy of all information that may come to his knowledge in the course of his duties.

There are, however, gateways. In particular, section 31(1B) provides that information can be disclosed for the purpose of enabling or assisting a foreign regulatory authority which exercises functions corresponding to those of the BMA. The gateway does not extend to client information.

Section 31 was amended by the Bermuda Monetary Authority Amendment Act 1999 which enabled disclosure to the Registrar of Companies and the Stock Exchange in certain circumstances.

14.3.1.2 ***BDCA***

Sections 39 and 40 of the BDCA permit the BMA to require a BDCA licensee to produce to it information, reports and documents. There is no restriction on access to client information.

Section 52 of the BDCA provides for the confidential treatment of information provided to the BMA.

However, by Section 54 of the BDCA, the BMA has the power to disclose information to a foreign regulatory authority exercising functions corresponding to those of the BMA under the BDCA, ie a foreign bank regulatory authority. The BMA may only disclose information to a foreign banking regulatory authority if it is satisfied that the authority is subject to restrictions on further disclosure at least equivalent to those imposed on the BMA under the BDCA.

14.3.1.3 ***IA***

Section 31 of the IA provides that the Minister may require an IA licensee to produce information to him. There is no restriction on access to client information.

Section 52 of the Insurance Act restricts the provision of information to foreign regulatory authorities. Information may only be disclosed:

- to the Minister of Finance, or other public officer, but so far only as may be necessary or expedient for the proper discharge of any function to be performed under the Act;
- for the purposes of civil or criminal proceedings;
- in summary form so that the identity of the person providing it cannot be identified.

14.3.1.4 ***IBA***

Section 20 of the IBA permits the BMA to obtain information from licensees. There is no restriction on access to client information.

The IBA does not contain any confidentiality provisions and gateways are not, therefore, necessary. Co-operation is covered by the BMA Act.

14.3.1.5 ***CA***

Section 4A(7) of the CA provides that information supplied to the Minister in an application for consent under the CA is confidential but may be provided to the BMA for vetting and recording the details of the beneficial owners of companies.

Section 4A (7) permits disclosure of information by the Minister of Finance for the purposes of enabling or assisting him to exercise or perform any functions conferred upon him by the CA.

14.3.1.6 ***Partnerships***

The registers of limited, exempted and overseas partnerships held at the company registry are open to public inspection. There is no information held or available in respect of ordinary partnerships.

14.3.1.7 ***Bermuda Stock Exchange***

The BSX may provide information to overseas regulatory authorities, but can only do so through the BMA. It is, therefore, subject to the restriction under the BMA Act.

14.3.2 **Compulsory powers**

Bermuda does not currently have legislation equivalent to the Model Compulsory Powers Ordinance. However, the BMA has advised us that, if it received a request for assistance from a foreign regulatory authority, it may be able to assist, provided it had a genuine need for the information itself, by obtaining the information for its own purposes and then passing the information to the foreign regulatory authority through the BDCA or BMA gateway.

14.3.3 **Memoranda of Understanding ("MOU")**

It is not the policy of the BMA to insist on formal MOUs, preferring less formal means of documenting formal commitment.

At present the BMA has only one operable MOU in place, this is with the Jersey Financial Services Department (now the Financial Services Commission) and was entered into in 1997. This MOU covers the protocol for communication between the regulators on jointly licensed entities, on-site visits in each other's jurisdictions and confidentiality.

A request from the Isle of Man Financial Supervision Commission for an MOU is outstanding but is being actioned.

Bermuda has requested an MOU with the Cayman Island Monetary Authority, as the Cayman Islands have required this to be in place before Bermuda can commence on-site visits in Cayman of the banks for which Bermuda has consolidated banking supervisory responsibility. Bermuda is waiting for the Cayman Islands to approve an MOU.

The MOU with Jersey expressly states how confidentiality is to be maintained.

14.3.4 **Confidentiality of information received from foreign regulatory authorities**

There are specific provisions in the BDCA which require the BMA to preserve the confidentiality of information received from foreign regulatory authorities. There is also a general provision of secrecy in Section 31 of the BMA Act.

14.4 **Co-operation between law enforcement authorities**

14.4.1 **Legislation**

14.4.1.1 ***USBTCA***

The USBTCA brought into effect the tax convention between Bermuda and the USA and covers the sharing of information on fiscal issues between Bermuda and the USA.

Under Article 5 of the Convention each party is required to assist the other in the carrying out of the other party's laws relating to tax and the evasion of tax.

Regulations have been made under the USBTCA covering the obtaining of information by examination and by documents.

14.4.1.2 ***CJICA***

The CJICA is similar to the UK's Criminal Justice (International Co-operation) Act 1990 (the "UK Act"). It gives substantial effect to the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

The provisions of the CJICA concerning co-operation include:

- the mutual service of process, in criminal matters;
- the mutual provision of evidence in criminal matters; and
- the issue of search warrants in Bermuda.

The provision of assistance does not require the offence to be a crime if it were committed in Bermuda.

Bermuda's CJICA has been amended to incorporate "ship rider" provisions which give enforcement powers to convention states over ships in Bermuda's territorial waters.

14.4.1.3 ***PCA***

Part VII of the PCA provides for the enforcement of external confiscation orders.

14.4.2 **Process of co-operation**

The Attorney-General is the central authority responsible for receiving requests from overseas law enforcement authorities to obtain evidence locally for use in connection with criminal proceedings or investigations in the requesting country. No separate budget has been allocated for this activity.

The Office of the Director of Public Prosecutions is responsible for prosecuting money laundering and other offences as well as making applications for forfeiture and confiscation of property.

Few requests have been made and none are outstanding.

14.5 **Requests to other jurisdictions for assistance in criminal and regulatory matters**

Few requests have been made of foreign law enforcement or regulatory authorities for assistance. Bermuda has not experienced any particular problems in receiving co-operation.

14.6 **Co-operation between regulatory and law enforcement authorities**

Apart from the BDCA there is no specific provision in either the BMA Act or any other financial regulatory legislation formally enabling the BMA to disclose matters to the police.

However, section 31(3) of the BMA Act permits the Minister, where he considers it desirable in the interests of public security or the detection of crime, to authorise any police officer of the rank of Inspector or above by warrant to inspect any of the books or records of the BMA.

In addition, the police can obtain a production order from the court to gain access to the BMA files.

Whilst the names of the registered shareholders are publicly available, as a result of the CA confidentiality provisions, the police would have to obtain a court order or the authority of the Minister before being granted access to the information on the beneficial owners of shares of companies held by the BMA.

There is currently no formal process under which the police advise the BMA of the results of investigations into fraud and money laundering.

14.7 **Co-operation on fiscal matters**

The USBTCA provides gateways with the USA for co-operation on fiscal matters.

The Criminal Justice (International Co-operation) Act 1994 extends to fiscal offences except that the Attorney-General shall not exercise his discretion where it appears that the request relates to a fiscal offence in respect of which proceedings have not yet been commenced unless:

- the request is from a Commonwealth country, or is made pursuant to a treaty to which the United Kingdom is a party and such a treaty has been made applicable to Bermuda; or,
- he is satisfied that the conduct constituting the offence would constitute an offence of the same or similar nature if committed in Bermuda.

This provision matches that contained in Section 4 (3) of the UK Act and permits co-operation provided the above criteria are met.

14.8 **Intelligence networks**

Bermuda has agreed in principle to participate in the Overseas Territories Regional Criminal Intelligence System ("OTRCIS"). This system, which is operated out of Miami is aimed to assist the UK Caribbean Overseas Territories law enforcement personnel to combat local criminality occurring in each individual Territory, as well as the threat posed by drug trafficking and organised crime including money laundering. OTRCIS provides a secure database on information relating to criminal and suspected criminal activity in the Overseas Territories.

14.9 **Support**

14.9.1 **Resources**

Whilst there are no individuals dedicated to the issue of international co-operation, there is no indication that there are insufficient resources available to provide information when requested.

14.9.2 **Legal support**

Legal support on matters of co-operation, both criminal and regulatory is provided by the Attorney-General's Chambers and the Director of Public Prosecutions.

14.9.3 **Egmont Group of Financial Intelligence Units**

The Bermuda Financial Intelligence Unit is a member of the Egmont Group of Financial Intelligence Units ("Egmont

Group"). The Egmont Group is a group of FIUs and similar bodies and was set up to facilitate effective international co-operation between FIUs in the interest of combating money laundering.

Egmont supports the FIU in Bermuda through information exchange, training and regional operational workshops.

14.9.4 White Collar Criminal Investigation Team

Bermuda does not currently participate in the White Collar Criminal Investigation Team ("WCCIT") though we are informed steps are being taken to join. This is a joint UK/FBI team operating out of the FBI offices in Miami. Currently two UK police officers are seconded to the team. These officers are also sworn in as police officers in each of the Caribbean Overseas Territories.

The role of WCCIT is to undertake and assist in the investigation of white collar crimes involving the US, the UK and the OTs in the Caribbean.

WCCIT does not have authority to initiate investigations in respect of drugs and drug related offences. There are resources available to assist the OTs with anti-drug trafficking investigations through the drugs liaison network in the region. There is also a UK-appointed Drugs Law Enforcement Adviser for the OTs available to assist with OT related drugs matters.

14.10 Issues and recommendations

14.10.1 Introduction

Bermuda has a strong legislative base for international co-operation. There is, however, the need for a number of specific improvements. The most important of these is an increase in regulatory ability to assist foreign regulators in investigations of Bermuda persons or entities.

Our specific recommendations for improvement are detailed below.

14.10.2 Co-operation between regulatory authorities

14.10.2.1 *Scope of existing gateways*

The Guidance Notes require that the statutory gateways should extend to client information. The gateway in the BMA Act is deficient and, in this respect, the BMA Act does not comply with international standards. We note, however, that it may be possible for the BMA to pass client information through the BDCA to a foreign banking regulator, as the BDCA does not contain the same restriction on the disclosure of client information.

We support the proposal of the BMA to make provision in specific regulatory statutes to enable the BMA to disclose client information to foreign regulatory authorities through the gateway. It is acceptable for the disclosure of client information to be restricted in accordance with regulatory need and to be subject to strict conditions.

As stated, the IA does not contain any gateways. As the BMA is not the regulator under the IA, the gateway in the BMA Act does not assist. We recommend, therefore, that gateway provisions are inserted into the IA.

14.10.2.2 *Compulsory powers*

We understand that the Model Compulsory Powers Ordinance was developed by the UK and discussed with the OTs at a number of Attorney-Generals' conferences. It is designed to provide OT regulators with powers to compel the production of information from both regulated and unregulated individuals and entities in order to satisfy a request for assistance made by a foreign regulator. As regulatory requests are civil rather than criminal, they cannot generally be made under legislation that enables the provision of assistance in criminal matters.

Bermuda has not adopted this Ordinance and is of the firm view that it has never been requested to do so and, therefore, is taking no action towards implementing it.

As indicated, the BMA considers that it does have some ability to assist overseas regulatory authorities by obtaining information using its own powers. However, this does not extend to persons who are not regulated by the BMA. In the circumstances, we do not consider that the legislation in Bermuda provides equivalence with the Model Ordinance.

We therefore recommend that Bermuda enact the legislation necessary to give full equivalence with the Model Ordinance, which we consider to represent good practice.

14.10.2.3 ***MOUs***

The TOR require that MOUs are put in place where necessary. As stated, Bermuda does currently have one operable MOU, with Jersey, but finds that informal arrangements work.

There is no evidence that the lack of MOUs is preventing or hindering the BMA from co-operating with foreign regulatory authorities.

An MOU is required with the Cayman Islands, however, as otherwise the BMA will not be able to undertake on-site inspections and will not be able to exercise consolidated supervision of licensees under the BDCA.

We recommend that the BMA continue to actively press for an MOU with the Cayman Islands modelled on the format recommended by IOSCO in "Principles of Memoranda of Understanding".

14.10.2.4 ***Confidentiality of information received***

The Guidance Notes require that regulators are able to safeguard the confidentiality of information provided to them by foreign regulatory or law enforcement authorities. There is no specific statutory provision concerning this.

Confidentiality is protected in the BDCA and a general duty of confidentiality exists under the BMA Act. We support the BMA's view that, in order to facilitate international co-operation and fully meet international and good practice standards, specific provision for the confidentiality of information received from foreign regulators and law enforcement authorities should be included in the other relevant regulatory statutes.

14.10.3 **Co-operation between law enforcement authorities**

14.10.3.1 ***USBTCA***

As a result of the pre-existing tax convention with the USA, Bermuda has not considered it necessary to enter into an MLAT with the USA. However, in order to provide a consistent approach with that taken by the Caribbean OTs, Bermuda is currently negotiating an MLAT with the United States. No timetable is yet in place for the completion of this process.

In the absence of an MLAT, the US law enforcement authorities may use the same channels for seeking assistance as the law enforcement authorities in other jurisdictions.

14.10.3.2 ***CJICA***

We consider that the CJICA provides equivalence to the UK Act. It also contains "ship riding" provisions. We consider that it meets international standards.

14.10.3.3 ***Restrictions on the ability to co-operate in relation to financial offences***

Given that dual criminality is not required under the CJICA, Bermuda has the ability to provide assistance on fiscal matters.

14.10.3.4 ***Tracing, freezing and confiscation of proceeds of crime***

The PCA provides for the enforcement of overseas forfeiture and confiscation orders. As indicated in the section of this Report on money laundering, the list of designated countries under the PCA is comprehensive.

The PCA depends upon dual criminality and therefore does not extend to conduct which may be a financial crime in a foreign jurisdiction but which is not an indictable offence in Bermuda (for example, insider trading and market manipulation). Therefore, the provisions which permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

Compliance could be achieved by extending the range of financial crimes in Bermuda.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or "flee" clauses. For the reasons set out in the section of this Report on Trusts, we do not consider asset protection trusts to be significant in Bermuda. Please see our recommendations concerning "flee" clauses in the section on Trusts.

14.10.3.5 ***Co-operation between regulatory and law enforcement authorities***

Whilst the contacts between the BMA and the police are good, in order to demonstrate compliance with good practice guidelines there needs to be a formal communication process, whereby the police advise the BMA of the findings or investigations relating to fraud and money laundering.

14.10.4 **Transparency in co-operation**

As Bermuda prefers not to enter into formal MOUs, we consider that, in order to fully demonstrate compliance with IOSCO Principle 12 it should produce guidance for other regulators on how and when it can provide assistance. The guidance should also make clear what requirements need to be satisfied before co-operation can be given. It would be helpful for those guidelines to be published on the BMA website.

14.10.5 **WCCIT**

We consider that it would be of benefit for Bermuda to participate in the WCCIT programme as it would both provide additional intelligence and investigative capability.

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15 Anti-money laundering

15.1 Introduction

A number of international standards are in place setting legislative and practical measures that should be taken to combat money laundering. These are contained principally in the FATF 40 Recommendations and the CFATF 19 Recommendations, the Vienna Convention and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. We are asked to consider to what extent the OTs apply the standards set out in these documents together with those contained in the EC Money Laundering Directive (June 1991).

Our review falls into two parts. The first is a review of the legislation, regulations and guidelines in place. The second is a review of the implementation of the legislation, regulations and guidelines, especially as regards the reporting, handling and investigation of suspicious transaction reports.

15.2 Factual assessment

15.2.1 Legislation

15.2.1.1 *Introduction*

Bermuda has two pieces of legislation that relate to money laundering, namely:

- the Proceeds of Crime Act 1997; and
- the Criminal Justice (International Co-operation) Act, 1994.

The PCA encompasses both drug trafficking and all crimes money laundering.

A Bill to amend the PCA has been enacted but not yet brought into force. We have considered the provisions of this Bill for the purposes of our Review.

15.2.1.2 *Proceeds of Crime Act 1997*

15.2.1.3 *Offences*

The PCA was enacted to implement the drug trafficking aspects of the Vienna Convention in Bermuda. The following money laundering offences were created by the PCA:

- concealing or transferring the proceeds of criminal conduct (Section 43);
- assisting another to retain the proceeds of criminal conduct (Section 44);
- acquisition, possession or use of proceeds of criminal conduct (Section 45); and
- tipping off (Section 47).

The PCA defines criminal conduct as drug trafficking offences and "relevant offences". There is a Schedule of relevant offences that includes most offences that could result in significant pecuniary gain, including corruption, fraud, counterfeiting, stealing and forgery. Criminal conduct is also limited to an act, or omission that would constitute drug trafficking or a relevant offence had it occurred in Bermuda. This concept is known as "dual criminality".

The *mens rea* for the above offences is as follows:

- the offence of concealing or transferring the proceeds of criminal conduct: "knowing or having reasonable grounds to suspect" that any property is or represents another's proceeds of criminal conduct;
- the offence of assisting: "knowing or suspecting" that the person assisted is or has been engaged in criminal conduct; and

- the offence of acquisition, possession or use: "knowing" that the property is the proceeds of criminal conduct.

15.2.1.4 ***Other provisions of PCA***

Sections 9 - 16 of the PCA enable the Court to confiscate the proceeds of drug trafficking and relevant offences and Sections 27 - 30 give the Court the power to make restraint orders and charging orders.

Sections 53 and 55 of the PCA establish procedures for registering at Court and enforcing foreign confiscation orders made by the Court of a designated country or territory. The list of designated countries and territories is comprehensive.

The PCA also provides for production orders (sections 37 and 38) and search warrants (section 39).

Section 41 of the PCA contains a provision by which the police can obtain a "monitoring order" under which a bank can be directed to give the police information obtained by the institution about transactions conducted through an account held by a particular person with the bank. This power, which is not contained in the UK legislation, enables the police to monitor a specific account over a period.

Under section 42, where a production order or a monitoring order has been made, the PCA contains provisions which make it an offence to disclose that fact if such disclosure is likely to prejudice the investigation into the criminal conduct or is intended to reveal the existence of the monitoring order.

Section 50 of the PCA enables a police officer to seize and detain cash which is being imported into or exported from Bermuda and which the officer has reasonable grounds for suspecting represents the proceeds of criminal conduct or is intended for use in criminal conduct.

Sections 45 and 46 of the PCA provide for the reporting of suspicious transactions to a police officer. The section provides that if a person makes a disclosure to a police officer:

- that disclosure shall not amount to a breach of any restriction on disclosure of information imposed by statute and shall not give rise to any civil liability; and
- provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

The offences under the PCA apply to "persons". A "person" includes an individual and a corporate body. Therefore both may commit offences under the PCA.

Section 58 of the PCA imposes a duty of confidentiality on a police officer in respect of any information or matter which he has obtained in the performance of his duties or the exercise of his functions under the PCA. No such information may be disclosed except in the performance of his duties or the exercise of his functions or when lawfully required to do so by any court or under the provisions of any enactment.

Section 49(1)(c) provides for the introduction of guidance notes for the prevention of money laundering.

15.2.1.5 ***The Proceeds of Crime (Amendment) Act 1999 ("PCAA")***

The PCAA has been passed but has not yet been brought into force. If brought into force, the PCAA will amend the PCA.

This Act changes the definition of "relevant offence" to mean all indictable offences, with the exception of drug trafficking offences (which are already separately covered in the PCA).

The PCAA originally contained a restriction on the extent of the scope of the PCA as it required that the proceeds of an offence committed abroad must be brought to Bermuda within three years of the act being done. We have been advised that this limitation will be removed and this amended provision has already been introduced for enactment during the current expression of Parliament. We support this decision.

15.2.1.6 ***The Criminal Justice (International Co-operation) Act 1994***

The CJICA enables Bermuda to co-operate with other countries in criminal proceedings and investigations and, in so doing, gives effect to the mutual legal assistance provisions of the Vienna Convention. This is discussed further in the section on international co-operation.

The CJICA also provides for the enforcement of overseas forfeiture orders in drug trafficking cases.

15.2.2 **Regulations**

The following regulations and orders have been made and issued under the PCA:

- the Proceeds of Crime (Money Laundering) Regulations 1998 ("PCMLR"); and
- the Proceeds of Crime (Designated Countries and Territories) Order 1998.

15.2.2.1 ***PCMLR***

The PCMLR apply to regulated institutions, including voluntarily regulated institutions.

The definition of regulated institutions is relatively wide, the notable exceptions being:

- lawyers and accountants;
- investment businesses exempted from the Investment Business Act 1999; and
- persons providing company formation and management services.

Essentially, the PCMLR requires regulated institutions to establish and maintain procedures concerning client identification, record keeping, internal reporting and training and the appointment of a compliance officer.

There is no requirement under the PCMLR for a regulated entity to verify the identity of customers with whom it had a business relationship at the time the regulations came into force.

Section 8 of the PCMLR provides that a person who carries on business without complying with the requirements of the regulations commits an offence. In determining whether a person has complied with the requirements of the PCMLR, the Court can take account of any relevant guidance issued by the National Anti-Money Laundering Committee.

The PCMLR do not cover the recruitment of employees or the need for an audit system to assess compliance with the regulations.

15.2.2.2 ***The Proceeds of Crime (Designated Countries and Territories) Order 1998***

This Order details those jurisdictions whose confiscation orders Bermuda will enforce (pursuant to sections 53 and 54 of the PCA) and in favour of which restraint and charging orders will be issued.

15.2.3 **Guidance Notes**

Guidance Notes on the Prevention of Money Laundering were issued by the National Anti-Money Laundering Committee under section 49 of the PCA in January 1998.

The Guidance Notes apply to all regulated institutions. They are not mandatory but they are designed to represent good practice and draw extensively on the Guidance Notes issued in the United Kingdom and Guernsey.

Adherence to the Guidance Notes is taken into account in any assessment of whether a breach of the provisions of the regulations has occurred.

The Guidance Notes cover areas such as customer verification, recognising and reporting suspicious transactions, keeping records and staff training.

In respect of introductions from third parties, no verification is required if the introduction is from a regulated person in a jurisdiction applying equivalent standards to those of Bermuda. Whilst such introducers are required to confirm that they have verified the identity of their client, there is an exception for clients who were existing clients of the introducer prior to 30 January 1998.

15.2.4 **Fiscal offences**

Tax crime will be a predicate offence if it falls within the definition of "criminal tax evasion" in Section 37 of the Taxes Management Act 1976 as amended by the Taxes Management Amendment Act 1999, which has been passed but is not yet in

effect.

Criminal tax evasion is defined as any wilful act by a person with intent to defraud where:

(a) that person knows that a substantial amount of tax would otherwise be due; and

(b) the conduct involved constitutes a systematic effort or pattern of activity designed to falsify material records to the relevant authorities.

Criminal tax evasion will be the only indictable tax offence in Bermuda and therefore the only fiscal offence where co-operation can be provided under the PCA.

Other tax offences are not indictable and therefore do not fall within the ambit of the PCA.

15.2.5 **Anti-money laundering - framework, system and procedures**

15.2.5.1 ***Reporting Authority and Financial Investigations Unit***

All reports of suspicious transactions are reported to the Financial Investigation Unit ("FIU"). The FIU and the Fraud Investigation Unit together comprise the Commercial Crime Department of the Bermuda police service.

The FIU was set up to administer the relevant provisions of the PCA and the PCMLR.

The FIU staff comprises three police officers, a Detective Inspector, a Detective Sergeant and a Detective Constable. The FIU budget is included in the overall police budget. The FIU is based on the UK model. A further officer has been appointed and joined the Unit in early May 2000. However, according to the FIU, the current volume of work may require additional resources beyond this.

Suspicious activity reports ("SARs") are made to the FIU on a prescribed form (in urgent cases the information may be telephoned or faxed). The FIU then issues an acknowledgement and, where appropriate, gives consent to continue with the transactions until further notice.

The FIU may seek additional information but will not approach the customer unless criminal activity has been identified.

The number of SARs for 1998 and 1999 are as follows (no earlier figures are available as there were no legislated reporting requirements prior to 19 January 1998).

Reporting entity type	Reporting entity total	
	1999	1998
Banks	24	35
Bermuda Stock Exchange	-	1
Collective Investment Scheme	1	-
Deposit Company	1,854	504
Long-term insurer	-	1
Non-regulated	6	6
	1,885	547

SARs are recorded on a structured database to enable analysis to be carried out.

A number of cases are still ongoing. Full and timely investigations into all reports received from deposit companies have not been possible given the FIU's present resources.

As a number of officers in the Commercial Crime Department are eligible for retirement, it is important that provision is made to ensure that effective succession arrangements are in place.

The BMA has not introduced any additional procedures in its supervision which specifically cover anti-money laundering systems. However the BMA is proposing to do so.

15.2.5.2 ***Bermuda National Anti-Money Laundering Committee ("NAMLC")***

NAMLC was established under section 49 of the PCA. Its composition includes the Attorney-General, the Director of Public Prosecutions, the General Manager of the BMA, the Financial Secretary, the Collector of Customs and the Commissioner of Police.

NAMLC was responsible for producing Bermuda's Anti-Money Laundering Guidance Notes.

15.2.5.3 ***Attorney-General's Chambers***

The Attorney-General's Chambers is the central authority responsible for receiving requests from overseas authorities to obtain evidence locally for use in connection with criminal proceedings or investigations in the requesting country. The Office of the Director of Public Prosecutions is responsible for prosecuting money laundering and other offences as well as making applications for forfeiture and confiscation of property.

The Attorney-General's Chambers is staffed with a Solicitor-General, a Principal Crown Counsel, a Senior Crown Counsel and three Crown Counsel. The Office of the DPP has ten prosecutors. There have been no money laundering cases in the last three years despite the high level of SARs which means that the DPP and his team do not have personal experience in prosecuting such cases. The DPP has advised us that, as in respect of all criminal cases, experienced counsel from outside Bermuda would be used if the need so arose.

Whilst staffing shortages at the Chambers in the past led to delays in responding to requests from other jurisdictions, the Chambers consider these to have been resolved. No statistical information on the time taken to respond to requests is currently maintained to enable verification of this.

The Chambers employ 3 pupils each year and are looking to extend this. Following pupillage, continued employment depends upon the existence of a vacancy in Chambers.

Although there have been no prosecutions for money laundering in the last three years, two applications for confiscation orders have been made and one order has been successfully executed.

15.2.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies, is primarily through participation in the FATF and the CFATF and other international organisations.

The NAMLC is tasked with monitoring money laundering threats and makes recommendations to the Minister of Finance on measures to be undertaken.

15.2.7 **Other measures to avoid money laundering**

There are no direct measures to detect or monitor cross-border transportation of cash and bearer instruments. Where cash, which includes negotiable instruments, is discovered being imported into or exported from Bermuda and there are reasonable grounds for suspecting that it directly or indirectly represents any person's proceeds of criminal conduct or is intended by any person for use in criminal conduct, it may be seized and detained. If the cash is being carried by a person, they may be questioned as to its source.

There are no requirements to report transactions above a certain value.

There is no measurement system in place recording the international flow of cash or bank transfers, into or out of Bermuda.

Bermuda's legislation does not distinguish between money launderers who are public officials and others, as envisaged by CFATF Recommendation 5.

15.3 **Issues and recommendations**

15.3.1 **Introduction**

Bermuda has a significant level of anti-money laundering provisions in place.

The PCA, the PCMLR and the Guidance Notes taken together are comprehensive and contain most of the material and covers almost all of the issues that we would expect in a jurisdiction that is fully compliant with international standards. We

consider that this is positive evidence of Bermuda's commitment to the prevention of money laundering.

Part III of the Criminal Justice (International co-operation) Bermuda Act 1994, as amended, and the Proceeds of Crime Act 1997, together with the Regulations and Guidance Notes made under this Act, were enacted to implement the Vienna Convention.

There are a few areas where we consider that enhancements are required if Bermuda is to fully comply with international standards, and these are addressed below.

15.3.2 **Legislation**

15.3.2.1 ***PCA and PCAA***

The PCA currently extends to the proceeds of drug trafficking to "relevant offences", which are listed in the Schedule to the PCA. Whilst this Schedule is extensive, it does not cover all indictable offences. As stated, when the PCAA is brought into force, the range of non-drug offences caught will be extended to all indictable offences in Bermuda.

The *mens rea* is different for the various money laundering offences. In this respect, Bermuda has followed the UK legislation. Nevertheless, we consider that the restriction of the *mens rea* for the offences of acquisition and assisting to "actual knowledge" should be extended to cover "reasonable grounds to suspect" as envisaged by CFATF Recommendation 4.

We are concerned that the confidentiality provision contained in section 58 of the PCA is too narrowly drafted, and that its terms are not sufficiently well defined. Our concern is that the section may not permit the Bermuda police to proactively disclose information to an overseas law enforcement or regulatory authority as it is not clear that he would be acting "in the performance of his duties or the exercise of his functions". This may inhibit Bermuda's ability to comply with FATF Recommendation 32.

15.3.3 **Regulations**

15.3.3.1 ***PCMLR***

We consider that in order to ensure that those institutions at risk from being used as part of the money laundering process are protected, as far as possible, the following additional groups are brought under the ambit of the regulations or are subject to equivalent requirements:

- those currently exempted from the ambit of the Investment Business Act 1999 (e.g. those dealing with high net worth individuals);
- entities carrying out reinsurance business, life insurance, disability insurance and principal representatives of insurance companies;
- professionals such as lawyers and accountants; and
- those engaged in the business of forming companies or providing company management and limited partnership services.

It is particularly important to bring professionals within the scope of the PCMLR given their role in the formation and management of companies.

Additionally, the regulations need to cover the recruitment of employees and the need for an audit system to test the effectiveness of the entity's anti-money laundering system. This is in order to bring it into compliance with FATF Recommendation 19.

We also consider that the exemption from the requirement to verify the identity of a client if the client was an existing client at the time the PCMLR were introduced is a weakness and not in accordance with good practice. It is possible that fictitiously named accounts or other relationships could have been established prior to the date the regulations came into effect and this exemption would permit their continued operation.

We note that Bermuda does not distinguish between launderers who are public officials and others, as envisaged by CFATF Recommendation 5. Sentencing discretion should enable the judiciary to set higher penalties for public officials who commit money laundering offences. We do not know whether sentencing policy reflects this.

15.3.4 **Guidance Notes**

We recommend that the Guidance Notes should be amended to require verification of existing clients for the reasons set out above in respect of the PCMLR.

15.3.5 **Financial Investigation Unit**

We consider that the volume of suspicious activity reports being received by the FIU and its responsibility for investigation means that it is currently insufficiently resourced to conduct this work. Whilst a further skilled officer has recently joined the unit, on secondment from the UK, this may well not be sufficient.

Similarly, whilst the existing officers in the Commercial Crime Department are experienced and well trained, a number of officers are eligible for retirement. Therefore, the issue of succession planning to ensure continuation of this experience and skill must be addressed.

15.3.6 **Monitoring of compliance by regulated institutions**

We consider that it would be good practice for measures to be introduced to enable the proactive supervision of licence holders to ensure they are complying with the PCMLR. We recommend that the BMA introduce a review of licence holders' anti-money laundering procedures into their on-site surveillance programme, and understand that this recommendation has been accepted and is being addressed.

We also consider that licence holders should be required either:

- to undertake an annual self-assessment of their anti-money laundering procedures and report to the BMA accordingly; or
- that a licence holder's auditors should undertake such a review.

The lack of on-site inspection programmes for certain licensed institutions means that FATF Recommendation 26 and CFATF Recommendation 11 are not being fully complied with. Recommendations in relation to this are contained in the Sections dealing with each type of regulated activity.

15.3.7 **Business awareness**

The PCA applies to all persons. However the Money Laundering Regulations and Guidance Notes only apply to regulated institutions. Lawyers and accountants, in particular, are not subject to the Regulations.

Bermuda is considering an awareness programme for those not covered by the Regulations and Guidance Notes to increase understanding of their responsibilities under the PCA. This is particularly important in preventing laundering of the proceeds of local drug sales.

As a matter of good practice, we consider that the proposed awareness campaign should be instituted as swiftly as possible. We recommend that it be extended to regulated institutions.

15.3.8 **Other regulations**

The requirements imposed on regulated institutions will need to be extended to other institutions (e.g. Fund Administration) when they come under regulation by the BMA.

15.3.9 **Cross-border flows of funds**

Bermuda should consider imposing a requirement upon its licensed banks and other relevant institutions to report cash flows to and from abroad, in accordance with FATF Recommendation 30 and CFATF Recommendation 15.

Appendix 1

PREAMBLE: REVIEW OF FINANCIAL REGULATION IN THE CARIBBEAN OVERSEAS TERRITORIES AND BERMUDA

The Overseas Territories' White Paper proposes establishing a renewed contract between the UK and the Overseas Territories (OTs). A modern and effective partnership should be built upon the foundations of responsibilities on both sides, coupled with the UK assisting the OTs where necessary, and the OTs exercising control over their own lives in a responsible way.

The UK is pledged to look after the OTs' interests internationally. This goes hand in hand with the OTs meeting accepted international standards, and playing a responsible role in the international community. In the area of offshore financial services, some of the OTs are significant players in their own right. The business conducted in offshore centres is often linked intrinsically with activities regulated in other countries, including the UK and our key international partners. The quality of regulation in the OTs has an indirect or direct effect on people, firms, and markets in other countries, as well as the international financial system.

The Terms of Reference provide for an indepth independent review by experts to assess progress made in the regulation of the offshore sector, and to make further recommendations on how to deal with outstanding issues. HMG circulated Guidance Notes to Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands which indicate accepted international standards and good practice in financial regulation. Following consultation with these OTS, the Guidance Notes and Terms of Reference for the review of financial regulation in the OTs have been revised.

2 September 1999

TERMS OF REFERENCE FOR THE REVIEW OF FINANCIAL REGULATION IN ANGUILLA, BERMUDA, BRITISH VIRGIN ISLANDS, CAYMAN ISLANDS, MONTSERRAT AND TURKS AND CAICOS ISLANDS

PURPOSE OF THE REVIEW

To assess Overseas Territories' (OTs) performance against international standards and good practice as set out broadly in the Guidance Notes[3].

To make recommendations for improvement where the OTs fall below these standards.

REGULATION OF FINANCIAL ACTIVITY

The review should list separately the type and composition of offshore financial services business in each OT ie. Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands. It should ascertain what legislation, regulations, rules, guidance, systems, and procedures (statutory or otherwise) govern the regulation and supervision of the:

- banking sector;

- insurance sector;

- securities sector, including mutual funds and stock exchanges.

This assessment should cover the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulation and laws.

The review should evaluate to what extent arrangements in the OTs meet standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to relevant standards provided by these bodies are broadly set out in the Guidance Note covering this section. The review should consider the adequacy of the system of supervision relative to the

objectives of an OT's financial services regulation. It should comment on the existence and adequacy of depositor and investment protection schemes. The review should determine whether further action is required by any territory in order to meet the standards broadly set out in the relevant Guidance Note, and prioritise recommendations.

REGULATION OF COMPANIES, PARTNERSHIPS, TRUSTS

The review should supply a breakdown of the type and composition of the company, partnership, and trust sectors in each OT, including company and trust service providers and formation agents, the involvement of professionals (accountants and lawyers), and the scale of activity. It should determine and assess the legislation, framework, systems, rules, regulations, guidance and procedures in place which provide for the regulation of activity in these sectors. The review should establish whether these arrangements conform to good practice and standards outlined in the relevant Guidance Note, which in turn refers to the principles set out in: the Basel Committee on Banking Supervision; International organisation of Securities Commissions (IOSCO); the Financial Action Task Force 40 Recommendations; Caribbean Financial Action Task Force Aruba Recommendations, the International Accounting Standards Committee, the G22 report on Transparency and Accountability (October 1998), IMF Guide to Progress in Strengthening the Global Financial Architecture (April 1999) and the OECD Principles of Corporate Governance.

The review should evaluate the appropriateness of the regulatory measures in place, including the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulations, and laws.

Furthermore, it should ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts. The review should detail the type of information available on the activities of company, partnership and trust. It should determine whether the mechanisms in place are sufficient. The review should also consider whether further action is required by any territory to meet the standards broadly set out in the Guidance Note, and prioritise recommendations.

INDEPENDENT REGULATORY AUTHORITIES

The review should evaluate to what extent regulatory authorities comply with accepted international standards advocated, principally, by Basel, IOSCO, OGBS and IAIS.

In particular, the review should evaluate whether regulatory authorities are accountable, independent and free from business and political influence, and properly staffed and budgeted for, with an independent source of income. It should determine whether the authority is detached from the marketing of financial services and where this is not so any impact this may have on the ability of the regulatory authority to regulate the sector objectively. The review should assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance, and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; cooperate with requests for assistance from foreign authorities and; enforce rules, regulations, laws by taking enforcement action, and the extent to which they can liaise with law enforcement authorities in the sharing of information. The review should consider which activities fall under the responsibility of the regulatory authority, and whether the regulatory net covers all financial activities. it should comment on the resources available to the authority, both for the purpose of recruitment, training and retention of staff and its infrastructure, such as the use of technology.

The review should consider what legal advice is available to the authority and its effectiveness in helping the OT government to regulate the sectors.

INTERNATIONAL COOPERATION

The review should evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of OT law enforcement and regulatory authorities to cooperate with requests for assistance from foreign authorities. The necessary requirements are broadly set out in the relevant Guidance Note. The review should ascertain what legal advice is available to OT regulatory and law enforcement authorities and its effectiveness in helping the OT government to co-operate in these areas. The review should determine whether further action is required by any territory in any of these areas, and the relative priority of such action.

<u>Cooperation between regulatory authorities</u>

The review should consider whether there are effective 'Gateways' provisions in place; OTs' powers to obtain information, including by compulsion; ability of foreign authorities to take voluntary testimony from OT residents; an OT's ability to

safeguard the confidentiality of information provided by foreign counterparts; provisions governing conditions under which information may be passed to overseas jurisdictions; whether effective Memoranda of Understanding exist, where required to underpin cooperation.

Cooperation between law enforcement authorities

The review should assess the extent of cooperation to which OT law enforcement authorities can obtain evidence on behalf of their foreign counterparts, and exercising other available mutual legal assistance powers, stating the mechanisms and OT authorities involved; an OT's ability to assist foreign authorities in tracing, freezing and confiscating proceeds in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (November 1990), even if the underlying conduct takes place outside the OT; the effectiveness of Mutual Legal Assistance Treaties with the USA where applicable, and the provision of basic statistics on the volume of requests for assistance made and received; powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted; ability to safeguard the confidentiality of information provided to OT authorities; whether effective Memoranda of Understanding exist, where required to underpin co-operation.

Cooperation between regulatory and law enforcement authorities

The review should evaluate whether there is effective cooperation

between law enforcement authorities and financial regulators, both domestically and abroad, as specified by the G7 key 10 principles. It should also consider the ability of OT regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

MEASURES TO COMBAT MONEY LAUNDERING

The review should establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the OT to combat money laundering, and types of offences caught by the legislation. It should determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.

The review should evaluate the effectiveness and adequacy of these arrangements, in terms of how they meet the standards broadly set out in the relevant Guidance Note, which in turn refers to: 1988 UN Drugs Convention; FATF 40 Recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990), and CFATF Aruba Recommendations. Furthermore, it should consider to what extent the OTs apply standards set out by the EC Money Laundering Directive (June 1991), the standards on which UK anti-money laundering legislation is based.

Specific consideration should be given to those offences considered predicate for the purposes of money laundering legislation; whether OTs have regulatory legislation in addition to the principle money laundering offences, and if not, whether guidelines and/or Codes of Practice exist (statutory or otherwise); their systems for reporting suspicious transactions and identifying customers; the institutions obliged to report; how reports are dealt with; and within what timeframe. The review should consider how this information is disseminated and shared with foreign counterparts. It should evaluate ability of Financial Intelligence Units (FIUs), or equivalents, to deal with suspicious transactions ie. whether staff have been properly trained and capable of conducting financial investigations and analysis; the resources at their disposal; feedback to the financial institutions.

The review should determine to what extent the AttorneyGeneral's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws. This not only relates to the prosecution of cases but the provision of assistance to foreign jurisdictions in pursuance of money laundering legislation.

FORMAT OF REPORT AND TIMESCALE

FCO, HM Treasury and OT representatives will wish to agree with KPMG the precise format of the report during Phase 1 of the workplan.

KPMG should provide written monthly reports to the Steering Committee (in electronic form) and attend Committee meetings at least during Phases 1, 2 and 5 (dates to be agreed).

10 December 1999

THE SUPERVISION OF THE BANKING, INSURANCE AND SECURITIES SECTORS

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories states that the Overseas Territories (OTs) should seek to implement "*legislation for the effective regulation of the offshore sector which fully meets accepted international standards*". In many cases the OTs have already implemented some of the standards, but no attempt is made here to analyse individual territories' performance to date. Such an analysis is the objective of the independent review foreseen in the White Paper, and to attempt it in the context of this paper would result in a superficial and incomplete impression of where matters stand. Instead, the purpose of this paper is to provide an overview of the framework within which international standards relating to the regulation of banking, insurance and securities business are established, and to offer an outline of the broad standards that have evolved. The paper is not intended to act as a substitute for the study of the detailed documents published by the respective standardsetting organisations, primarily the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to these documents can be found in the following text and, specifically, in publications available on the respective websites. The following are also key documents:

Core Principles for Effective Banking Supervision	Basel Committee	Sept 1997
The Supervision of CrossBorder Banking	Basel Committee	Oct 1996
Insurance Principles, Standards and Guidance Papers	IAIS	Oct 1998
Objectives and Principles of Securities Regulation	IOSCO	Sept 1998

THE OBJECTIVES OF SUPERVISION

2. The objectives of financial services supervision fall into four broad categories:

- to secure the appropriate degree of protection for consumers of financial services;
- to maintain confidence in the financial system;
- to promote public understanding of the financial system; and
- to reduce the scope for financial crime.

3. The protection of consumers' interests does not assume an absolute objective to prevent financial consumers from losing money, but rather to create an environment where financial risk is better understood, and where there is less chance of consumers taking unnecessary and excessive risks. As stated in a recent Occasional Paper published by the UK's Financial Services Authority, this process requires "*having regard to the differing degrees of risks involved in different kinds of investment, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions*"[4]. Delivery of the appropriate environment involves both proper transparency and disclosure by financial institutions, and the effective enforcement of laws, regulations and rules by the regulators.

4. Preservation of confidence in the financial system has at its core the need to mitigate the risk of systemic failure, or of the system falling into disrepute. This will not necessarily be focused on the narrow issue of whether individual depositors or investors are threatened with the loss of money, but on whether the system as a whole might be under threat from the failure of one or more institution. There are circumstances in which individual financial institutions can and should be allowed to fail without fear of a threat to the system, even though there might be losses for the customers of those institutions.

5. The rising tide of financial crime has increasingly posed threats to the integrity of financial systems. This impacts upon both the financial stability of institutions and upon the reputation of individual jurisdictions. Although financial services supervisors are not expected to police the wider criminal laws, it is clearly important for the supervisors to play their part in reducing the exposure of the financial services sector to criminal abuse, and in tackling financial crime and regulatory abuse. This requires OT regulatory authorities to have appropriate investigative powers and specialist enforcement branches, and to cooperate fully with the authorities in other jurisdictions. The responsibility for investigating individual cases of money laundering should, however, fall to OT law enforcement authorities.

THE SUPERVISORY FRAMEWORK

6. Perhaps the single most important aspect that underpins the integrity of the financial services sector is a longterm political commitment to effective regulation and supervision. Without such commitment the regulators will always be starved of the tools needed to achieve an effective result.

7. Fundamental to this process is a willingness to enact comprehensive regulatory legislation, to develop the associated regulations, rules and guidance, and to keep this structure under review to ensure that it stays abreast of trends both in the financial services industry itself, and in the development of regulatory practices. While the individual techniques of supervision and enforcement may vary in order to address the respective distinctive features of the offshore and domestic sectors, the fundamental standards applied to the offshore sector should not differ from those expected for the domestic market. With regard to the offshore sector, it is essential that due regard is paid to the regulatory implications in tandem with any moves taken to facilitate the development of business. Moreover, there should be no attempt to encourage "regulatory arbitrage" by seeking to offer a lighter regulatory regime than exists in competitor jurisdictions.

8. A central part of the legal framework must be provision for an effective, operationally independent and accountable regulatory authority with the appropriate powers to fulfil the objectives identified in section 2. However, legal form alone is not sufficient to provide the basis for an effective regulatory system. There needs also to be an allocation of resources in line with the structure, scale and complexity of the financial services sector. This involves an acceptance of the need to invest in the staff and infrastructure of the regulatory authority in order to ensure that it has appropriate skills and tools to meet the tasks expected of it. It has also to be recognised that there can be no formalistic approach to the funding of the regulatory regime, based, for example, on the direct benefit derived by government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision. By entering the offshore market a jurisdiction has to accept that not only does it have a duty to preserve the reputation and standing of its own financial system, but that it also assumes a wider responsibility to the international community to help ensure the integrity of the global market.

THE DEVELOPMENT OF INTERNATIONAL STANDARDS

9. The increasing internationalisation of financial services in the past decade has led to a drive to establish some common minimum standards of supervision. The application of these standards is seen as particularly important in financial centres with a high proportion of international business, since the failure of supervision there may have far wider implications than simply for the local market.

10. Standards for the supervision of the banking sector have been developed over many years under the auspices of the Basel Committee on Banking Supervision which promulgated the first Basel Concordat in 1975. In recent years there has been a rapid increase in publications emanating from Basel, many of which are intended to represent accepted international standards. Although the Basel Committee is an organisation whose membership comprises the G10 countries, it has a number of "regional" affiliates, not least of all the Offshore Group of Banking Supervisors, which have been closely involved in the development of the standards in recent years. The list of publications produced by the Basel Committee is available on the website of the Bank for International Settlements (www.bis.org). In the context of this paper the most significant of the documents are *The Core Principles for Effective Banking Supervision* (published in September 1997), which delivers 25 basic principles, and *The Supervision of CrossBorder Banking* (published in October 1996), which contains 29 recommendations.

11. In the insurance sector standards are increasingly being established by the International Association of Insurance Supervisors (IAIS). The IAIS was established in 1992 and has membership of about 100 jurisdictions, including several offshore centres. Until 1996 it had no standardsetting powers, but since that time has produced a number of standards and guidance papers. These are consolidated within the *Insurance Principles, Standards and Guidance Papers* published in October 1998. The IAIS standards focus on particular supervisory issues, describing the best or most prudent practices, while the guidance papers are designed to assist regulators to raise the effectiveness of supervision. The IAIS is in the process of developing a website which should be available shortly.

12. The primary international standards body in the securities sector is the International Organisation of Securities Commissions (IOSCO). Like the Basel Committee, IOSCO has been working over many years and published its first *Resolution on the Regulation of Securities Markets* in 1983. Unlike Basel, its membership is big (over 90 countries) and includes a large number of emerging markets and offshore centres. IOSCO's bylaws include clear objectives, with which all members are expected to comply. They include the requirements for members to cooperate, to promote high standards of regulation, to apply the standards rigorously, to establish effective surveillance and enforcement, to maintain just, efficient and sound markets, and to exchange information. In September 1998 IOSCO published its *Objectives and Principles of Securities Regulation* which sets out the 30 Core Principles of securities regulation. In addition, IOSCO has over the years

produced a substantial range of other documents which represent commitments by the membership, guidance or standards, and which are available on its website (www.iosco.org).

13. Although membership of these standardsetting organisations, or their affiliates, has been open to offshore centres, acceptance of, and compliance with the principles that the organisations espouse are essential preconditions for membership.

OVERVIEW OF THE COMMON PRINCIPLES

14. It has to be reiterated that the documents referred to in this paper are essential reading, and it is not the intention of this paper to provide a substitute summary. However, in considering the structure of the overall regulatory regimes required in the OTs it is important to identify the common themes that underpin the regulation of all three sectors. This section seeks to highlight these themes. However, it is important to appreciate that, while there are common characteristics of the regulation of the different sectors of the financial services industry, different skills and processes will be required to effect proper regulation of each sector. The reference documents address these differences.

A. General Principles

a) Regulation should be vested in a properly constituted authority which should be operationally independent from political and commercial interference in the exercise of its functions. However, it should also be openly accountable in the exercise of its powers (see also the separate paper on *Independent Regulatory Authorities*).

b) The regulatory authority should have a clear, adequate, achievable and consistent framework of responsibilities, objectives and powers set by legislation, and it should adopt processes which are fair, consistent, transparent to the public, and demonstrably geared towards achieving the objectives.

c) The regulatory authority should have adequate funding to enable it to acquire the resources (staffing, technology, infrastructure etc) to fulfil its responsibilities. The funding should be available in such form that it does not compromise the authority's independence from both political and commercial pressures.

d) The regulatory authority should have due regard to the need to compete with the commercial sector for skilled staff, and should structure its terms and conditions of employment accordingly. It should also ensure that its staff receives ongoing training.

e) The system of supervision should involve both offsite surveillance and onsite examination. This requires the regulatory authority to have the powers not only to set the scope, content and frequency of routine reporting by regulated institutions, but also to have access, whenever it considers it appropriate, to the books, records, accounts and other documents maintained by the institutions. There should be no secrecy barriers to limit the regulators' access to information.

f) The regulatory laws should establish proper licensing standards and criteria, and the regulatory authority should adopt effective procedures to ensure that applications are reviewed in a thorough and consistent manner. As a minimum this should require the implementation of comprehensive due diligence procedures in relation to controllers, directors and managers of prospective licensees, and a detailed analysis of an applicant's business plan, internal controls, projected financial condition and likely ability to comply with established prudential standards.

g) The regulatory laws should provide for notification of any intended change in ownership or control of a regulated institution, and for such changes to be subject to prior approval by the regulatory authority.

h) The regulatory authority should have the powers to implement and enforce prudential standards both generally across the entire sector, and specifically in relation to individual institutions. For example, this requires that the authority adopt and enforce suitable standards for capital adequacy, solvency, liquidity, risk concentration, asset valuation etc, taking account of accepted international standards and guidelines.

i) The regulatory authority should require institutions to maintain minimum standards of corporate governance, internal controls and operational conduct with the aim of protecting the interests of clients, ensuring proper management of risk, and accepting primary responsibility for these matters. Careful attention should be paid, for example, to the role and responsibilities of the board of directors, the arrangements for delegating authority and responsibility, the separation of duties, the safeguarding of assets and the procedures for internal audit.

j) Regulated institutions should be required to maintain proper books, records and accounts.

k) There should be procedures for dealing with the failure of a market intermediary in order to minimise damage and loss to financial consumers and to contain systemic risk.

1) The regulatory authority should be vested with comprehensive and credible inspection, investigation, surveillance, and enforcement powers, including

- powers to take action to ensure compliance with regulatory requirements;
- powers to impose administrative sanctions for noncompliance;
- powers to initiate or refer matters for criminal prosecution; and
- powers to suspend or revoke authorisation to conduct business.

m) Regulated institutions should be subject to independent external audit in accordance with international accounting standards, and should be required to disclose to the public information regarding their activities and financial position that is comprehensive and not misleading. This information should be sufficient for financial consumers and market participants to assess the risk inherent in individual institutions.

n) The establishment of trading systems, including securities exchanges, should be subject to regulatory authorisation and oversight. Trading should be supervised in a way which ensures that the integrity of the market is maintained. There should be fair and equitable rules which strike an appropriate balance between the demands of different market participants.

o) Market regulation should promote the transparency of trading, be designed to detect and deter manipulation and other unfair trading practices, and aim to ensure the proper management of large exposures, default risk, and market disruption.

p) Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and be designed to ensure that they are fair, effective and efficient, and reduce systemic risk.

q) The regulatory system should set appropriate standards for the eligibility and regulation of collective investment schemes; provide for rules governing their legal form and structure, and for the segregation and protection of client assets; require disclosure necessary for evaluating the suitability of a scheme for particular investors; and ensure that there is a proper and transparent basis for the pricing and redemption of units.

r) The regulatory authority should have the powers and procedures to ensure that regulated institutions take action to protect themselves against criminal misuse, and that they maintain appropriate systems to comply with anti-money laundering regulations.

B. Cross-Border Issues

a) The regulatory laws and supervisory policy and procedures of a jurisdiction should seek to ensure that no institution operating across national boundaries escapes supervision, and that the supervision should be effective. In this context attention should be paid not only to corporate structures that might frustrate effective consolidated supervision (e.g. parallel-owned entities), but also to arrangements where the physical location of the licensee's mind and management differs from that of the regulator (e.g. shell branches).

b) The creation of a crossborder establishment in the regulated sector should be subject to prior consultation and agreement between the home and host regulators. This is essential not only to ensure proper assessment of the application, but also to enable both parties to agree the necessary procedures for ongoing supervision of the institution.

c) The regulatory authority should be empowered to collect both public and nonpublic regulatory information, and to share this in accordance with international principles with domestic authorities and foreign counterparts. Co-operation in the exchange of such information involves exchanges of a routine nature and the provision of assistance in an enforcement investigation, as well as in the event of the emergence of serious problems (see also the separate paper on *International Cooperation*).

d) The regulatory authority should have the powers to assist an overseas regulator in the fulfilment of its functions. This may involve assistance in obtaining information or records, but will also extend to the use of investigative or

compulsory powers on behalf of the overseas regulators. Secrecy or confidentiality provisions in the law of a jurisdiction should not be used as a means of impeding such assistance.

e) There should be no barriers to prevent a home country regulator from undertaking such procedures, and having access to such information in the host country as it considers necessary to undertake the effective consolidated supervision of an international financial services group.

THE FUTURE DEVELOPMENT OF STANDARDS

15. The rate of development of internationally recognised and accepted regulatory standards has accelerated in recent years, and further announcements should now be expected on a regular basis. Therefore, it is important to appreciate that compliance with international standards is not a static or "oneoff" process, but will require regular updating of laws, policies and procedures. With this in mind, regulatory authorities in the OTs should continue to monitor international developments, particularly where they participate in or are affected by the work of one or more of the key international standardsetters mentioned above. They should, in particular, be prepared to recommend changes in legislation where appropriate, and to implement new procedures to ensure that compliance is kept up to date. This applies in all three of the main sectors referred to in this paper.

IMPLEMENTATION

16. Standardsetting is not, by itself, enough. It needs to be accompanied by active monitoring of compliance with these standards, and the commissioning of the independent review of the OTs must be seen in the wider context. The G7 report on *International Financial Architecture*, agreed at Cologne, said:

"*With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation*."

17. The standardsetting regulatory bodies the Basel Committee, IOSCO and IAIS are now working increasingly closely with the IMF and the World Bank. In the field of banking supervision, for example, the Basel Committee, the IMF and the World Bank, working with selected supervisors around the world, have developed a *Core Principles Methodology* text which provides detailed guidance to the IMF and World Bank for their assessments of compliance. It is expected that such assessments will be made for an increasing number of countries and territories around the world; and that the results of such assessments will be used by regulators (see for instance the Basel Committee's consultative paper on a *New Capital Adequacy Framework*) and by the Washington institutions (as a precondition in the IMF's new Contingency Credit Line).

18. An IOSCO Implementation Committee, in which the IMF, World Bank and the regional development banks participate, has been set up to oversee the implementation by IOSCO members of the 30 Core Principles. Cooperation between IOSCO and the international financial institutions is at the heart of this process.

COMPANIES AND TRUSTS

1. There are legitimate reasons for using company and trust vehicles. However, the White Paper "Partnership for Prosperity" (Appendix 2, paragraph 4) states "We shall also press Overseas Territory governments to introduce legislation to improve regulation of company formation and management because, for example, in the absence of proper regulation, complex company structures can be used to disguise the proceeds of crime and other regulatory abuse as well as providing limited liability." The White Paper continues "Company formation agents and company managers need to be required by law to hold key information about the companies for which they have responsibility and to disclose that information to a regulator on request. This will ensure a properly documented paper trail for criminal and regulatory investigations."

2. This paper considers the issues of company and trust regulation relevant to the regulation of the financial system. The paper does not set out a blue-print for Company and Trust Law and regulation as a whole - that would be outside the scope of the Review, and constitute a major undertaking in its own right. The two sectors - companies and trusts - fulfil very different purposes, and their regulatory regimes have evolved in different ways, to meet different objectives. Nevertheless, in respect of their potential as vehicles for abuse, the issues raised by the trust and company sector are similar, and for this reason, this paper treats them in parallel. But the Review may wish to consider them as distinct sectors.

4. The opportunities for companies and trusts to be used for criminal purposes cannot be removed. Effective regulation can help reduce the scope for criminal abuse of such vehicles. There is no single international group of company and trust regulators. Nevertheless, the regulatory principles established by other international bodies in relation to other financial sectors apply equally well to the company and trust sectors:

The principle that financial institutions should know their customers (established by - among others - the Basle and IOSCO standards) applies with particular relevance to situations in which the ownership of assets may be obscured through company and trust vehicles;

FATF Recommendation 11 requires financial institutions "*to take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located)*". The interpretative note to this recommendation states "*a bank or other financial institution should know the identity of its customers, even if these are represented by lawyers....accordingly, recommendation 11 also applies to the situation where an attorney is acting as an intermediary for financial services*". This accepted international standard implies that financial institutions should be able to delve beneath a corporate or trust structure, to establish the true beneficial owner and other relevant parties, and not simply the name of a lawyer acting as an intermediary.

The FATF's Recommendation 25 states "*Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities*";

International standards on accounting, disclosure and auditing practice; covering timeliness in the provision of financial information, completeness, consistency, risk management, audit and control. The relevant standards include those set by the International Accounting Standards Committee; the G22 report on transparency and accountability, October 1998; and the IMF *Guide to Progress in Strengthening the Global Financial Architecture*, April 1999). These standards are particularly relevant when there are obligations to third parties arising;

Standards of corporate governance, reflected in the *OECD Principles of Corporate Governance*, which OECD members, in co-operation with the World Bank and IMF, are committed to promoting amongst non-member countries;

The Home Office report on "*Financial Regulation in the Crown Dependencies*" (The "Edwards Report") makes specific recommendations, based on the internationally accepted principles outlined above, for the company and trust sectors of the Isle of Man, Guernsey and Jersey.

5. Satisfying these principles implies the following;

(i) Beneficial ownership.

It should be possible for law enforcement and regulatory authorities to ascertain, quickly and efficiently, and in advance of formal proceedings, the true owner of assets held by a company or trust, and the source and nature of financial transactions. It is essential to be able to trace the ultimate individual beneficial ownership of companies and to get beyond elaborate structures in which companies are owned by layers of other companies and/or trusts, which obscures the ultimate owner.

In the company sector, this would involve the OT authorities having the means to identify company directors and the beneficial ownership of shares, eg where nominees exist. Effective custody arrangements would need to be in place in relation to bearer shares. In the trust sector, OT authorities should have the means to be able to identify the settlor, the beneficiaries, the trustees, the protector, and the custodian, where applicable, and should be able to obtain a copy of the trust instrument. This would help identify 'sham' trusts, for example. OT authorities should have the means to obtain up-to-date information, and to obtain such information in relation to companies and trusts which might be established in other jurisdictions, yet which might be managed or move to the OT concerned.

(ii) Anti-money laundering systems.

Intermediaries providing corporate or trust services should have in place effective anti-money laundering measures, including "know your customer", record keeping, and staff training requirements. Suspicious transactions involving companies and trusts should be disclosed to a Financial Intelligence Units. (More details on anti-money laundering standards are set out in the 'Money Laundering Guidance Note').

(iii) Transparency of financial arrangements.

Basic financial information relevant to the activities of companies and trusts should be available, quickly and efficiently, and in advance of formal proceedings, to law enforcement and regulatory authorities. Ideally, such information in the company sector should also be available to customers, shareholders, suppliers and lenders, where appropriate. In the trust sector, trustees should ideally be held accountable to the beneficiaries by preparing regular accounts, where appropriate,

which might also be available to the settlor and protector where applicable.

The Review will wish to consider in which circumstances it would be appropriate to require accounts to be produced, in which circumstances such accounts should be made public, in which circumstances abbreviated accounts might be acceptable, and in which circumstances the requirement to produce accounts should not be applied. The latter might apply where single asset holding vehicles exist with no third party involvement.

(iv) Obligations on directors, trustees, and company and trust service providers.

Measures should be in place to ensure that directors and trustees fulfil their "due diligence" obligations effectively, and to prevent nominees from assigning their responsibilities to others through general powers of attorney, and being used as a cover for criminal activities and regulatory breaches. More generally, those who provide corporate and trust services should be licensed, and subject to effective regulation. The "four eyes" principle should apply. The codes which apply to company and trust managers should be complementary, for example to avoid a situation in which inter-linking ownership of company and trust vehicles can be used to obscure beneficial ownership. OT authorities should be able to identify the true directors and owners of a company, and the settlors, beneficiaries, trustees, protectors, and custodians of a trust. The rules, regulations, and laws relating to insolvency and bankruptcy should also be examined by the Review, to ensure that these may not be abused, eg for the purpose of defrauding shareholders.

(v) Investigative and enforcement powers.

OT authorities should be able to apply full investigative powers to those (eg directors, beneficial owners, settlors, beneficiaries, trustees, nominees) who are suspected of criminal activity. This extends to applying the compulsory powers referred to in the paper on 'International Co-operation'. OT authorities should be able to identify the links which may exist between companies and trusts. OT authorities should launch appropriate investigations in the face of bankruptcy and insolvency. More generally, the regulation of company and trust service providers and formation agents needs to be accompanied by effective and independent enforcement powers, including the power to monitor and supervise licensed formation agents and service providers, to inspect their activities, to investigate potential breaches of rules, regulations, and laws, and to take appropriate enforcement action. The latter would include the ability and willingness to take disciplinary action (eg remove licences) as well as to pursue civil and criminal sanctions.

(vi) Removal of impediments to asset tracing and seizure.

Trust and company arrangements should not be able to be used to frustrate the due process of law in attempts to trace and seize assets.

INDEPENDENT REGULATORY AUTHORITIES

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories explains that one of the "key components of the regulatory package we wish to see in place by the end of 1999" is "the establishment of independent regulatory authorities meeting accepted international standards". The Financial regulation checklist appended to the White Paper provides further detail on what this amounts to.

2. Four publicly available papers provide more specific details on what the international community expects from a regulatory authority. These documents are (i) "Objectives and Principles of Securities Regulation" by the International Organisation of Securities Commissions; (ii) "Core Principles for Effective Banking Supervision" by the Basle Committee on Banking Supervision; (ii) "The Supervision of Cross-Border Banking" by the Basle Committee on Banking Supervision and the Offshore Group of Banking Supervisors; (iv) "Insurance Principles, Standards and Guidance Papers" by the International Association of Insurance Supervisors.

KEY FEATURES

(i) Independence

3. Independence is required in order to generate confidence, in particular that all market participants will be treated objectively and fairly, and that rules and regulations will be applied uniformly in such a way as to protect investors and promote orderly market activity. These objectives will not be satisfied unless the regulatory authority is clearly seen to act independently, and to have sole responsibility for regulating market activity.

4. The concept of independence does not imply that regulatory authorities are unaccountable. Instead, it implies that their day to day operations should be free from political or commercial control and influence. These executive operations include all the regulator's key functions, such as (a) deciding to issue, suspend, and withdraw licences; (b) supervising and inspecting the activities of licence holders, including issuing rules and regulations; (c) undertaking investigations; (d) taking enforcement action, and; (e) co-operating with overseas authorities. The regulatory authority should have the necessary powers and ability to regulate all licensed activity.

5. Proper independence requires the regulatory authority to exist as a stand-alone body, rather than as eg a separate unit within the Finance Ministry. Independent regulatory authorities are typically established by statute, which sets out the authority's powers and responsibilities. Those working in the authority, including senior management, should not have any external commercial or political interests or responsibilities (including unpaid directorships). The regulatory authority should not be required to secure OT government approval before exercising its executive powers.

6. Independence extends to the authority's functions. The regulatory authority should not be charged with any political or commercial responsibilities. In particular, the authority should not seek to market its jurisdiction as a place for business to locate. All such hard selling and marketing should be undertaken by a separate body which is not connected in any way with the regulatory authority (again, members of staff should not work in both bodies). Such separate promotional bodies should not be funded by the regulatory authority. Essentially, the job of selling the merits of doing business in a particular OT should be left either to OT governments or to the private sector. It would, however, be open to the regulatory authority to provide information about the regulatory regime in the jurisdiction to potential inward investors.

7. Independence extends to the way in which the authority is resourced. Regulatory authorities should be self-supporting and have their own source of income, independent from Government control. This is often raised through licence fees or another form of industry levy. Where these fees currently account for a large proportion of OT government income, the authority would return any excess income to the government.

8. Independence does not imply isolation. The regulatory authority should consult both the industry and the OT government before seeking to make any changes to broad regulatory policy, and before seeking to make changes which have national policy implications, or which have significant implications for the industry. These implications can properly include considerations of internal and external competitiveness, within the parameters of relevant international standards.

(ii) Accountability

9. Independent regulatory authorities are subject to a number of checks and balances, which in turn ensure that they are held accountable for their actions. In particular;

(a) Statutory objectives. The objectives of the authority should be laid down by statute drawn up by the OT Government. These objectives should reflect the need to satisfy internationally accepted standards of regulation.

(b) Appointments. The authority should operate under a properly constituted board or Commission, which holds a mix of relevant expertise. All board/Commission members should be appointed on the basis of that expertise by the OT Government, or by the Governor in consultation with the OT Government (eg where the Governor retains responsibility for the offshore sector). All key policy decisions should be approved by the board.

(c) Legislation. Legislation covering financial regulation as a whole will often need to be amended or introduced in order to make any significant changes to the regulatory regime. Regulatory authorities do not normally have the power to make such legislation, and will need the support of those who do if significant changes are to be made to the regulatory regime.

(d) Annual report. The authority should produce an annual report available to the public explaining its operations over the past year, how its objectives have been tackled, how resources have been allocated, and how it intends to tackle its objectives in future. This would include publishing a set of audited accounts and possibly a Statement of Principles. The annual report should identify where problems have been encountered in meeting international standards, and how the authority intends to deal with these problems. OT Governments should question the authority in relation to its annual report.

(iii) Functions and powers

10. The documents mentioned in paragraph 2 provide full detail on the types of function expected of a regulatory authority. For the purposes of this paper, it is worth noting simply that the regulatory authority should have sole responsibility and

powers in the following areas. These functions relate to the regulation of activity;

(a) Licensing. The regulatory authority should have sole responsibility for issuing, suspending, and withdrawing licences. This extends to having the powers and ability to investigate whether persons are 'fit and proper' to work for a licensed firm.

(b) Determining how licensed firms and persons should conduct business. The regulatory authority should have sole responsibility for setting conduct of business rules and regulations, and providing guidance for market practitioners. Where legislation is required, the authority should be able to make proposals to OT governments.

(c) Supervising and monitoring licensed activity. The regulatory authority should monitor all licensed activity. This would involve establishing regular (eg quarterly) reporting systems plus a programme of regular and 'surprise' inspections. The regulatory authority should not require the prior approval of any external body before conducting such inspections.

(d) Investigating. The regulatory authority should conduct in-depth investigations into suspected breaches of rules, regulations, and laws. The regulatory authority should have the power to compel the production of information from both licensed and unlicensed firms and persons, in the ways outlined in the paper on 'International Co-operation'. In particular, the regulatory authority should not pursue criminal investigations outside the regulatory function - the law enforcement authorities should be responsible for leading those investigations.

(e) Taking enforcement action. The regulatory authority should have the powers to take appropriate enforcement action in response to breaches of rules, regulations, and laws. This would include the ability to suspend and withdraw licences, the ability to issue directions, and the ability to levy fines. Where criminal activity is encountered, lead responsibility for taking enforcement action would normally fall to the law enforcement authorities in conjunction with the prosecuting authorities.

(f) Co-operating with other authorities. Where serious breaches are encountered, the regulatory authority would be expected to co-operate fully with other authorities within the OT, such as prosecuting and law enforcement authorities. This would essentially involve the regulatory authority handing over information it had obtained before it became clear that criminal activity was at hand, rather than the regulatory authority undertaking any criminal investigations. OT authorities should also co-operate fully with authorities based overseas, in the ways outlined in the paper on 'International Co-operation'.

(iv) Resources

11. The regulatory authority should be properly resourced in order to meet these responsibilities effectively, and a certain critical mass is required. This includes having access to legal and accountancy advice from sources which do not suffer from a conflict of interest. Regulatory authorities should have their own source of stable ring-fenced income, independent from Government or other political control and influence. This income is often raised from the industry in some way.

12. As stated in the paper 'The Supervision of the Banking, Insurance, and Securities Sectors', resources should be allocated 'in line with the structure, scale, and complexity of activity. The funding of the regulatory regime should not be based on the direct benefit derived by the OT Government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision'.

(v) Liabilities

13. Regulatory authorities are normally subject to statutory immunity from prosecution, in order to allow them to conduct their regulatory functions more effectively. Other jurisdictions are more likely to recognise this immunity if the regulatory authority matches up to international standards, in the ways outlined above. The converse is also true.

14. Properly resourced regulatory authorities which perform their functions in the ways envisaged by the documents mentioned in paragraph 2 are also much less likely to get into the sorts of situation where their actions might be subject to legal challenge. For example, the regulatory authority should be able to demonstrate that any problems did not arise as a result of substandard regulation.

INTERNATIONAL CO-OPERATION

INTRODUCTION

1. By their very nature, offshore centres conduct business which is linked with that in other financial centres. For this reason, it is important that offshore centres cooperate fully with requests for assistance from authorities in other jurisdictions. This includes both regulatory and law enforcement authorities. The types of assistance referred to in this paper do not include co-operation relating to fiscal matters.

2. The White Paper on Britain and the Overseas Territories explains that one of "the key components of the regulatory package we wish to see in place by the end of 1999" is "powers to ensure that, whatever the secrecy laws, regulators and law enforcement in those Overseas Territories with financial sectors can cooperate properly with their overseas counterparts, including on investigation and enforcement matters".

3. Assistance should extend to;

(i) Regulatory authorities sharing confidential regulatory information held on file or obtainable from licensed bodies.

(ii) Regulatory authorities obtaining information by compulsion from unlicensed bodies, and obtaining client information by compulsion from licensed bodies (where clients refuse to disclose this information voluntarily).

(iii) All such exchanges of information between regulatory authorities to take place under cover of a bilateral Memorandum of Understanding signed by each party, setting out the terms and conditions of assistance, including that the confidentiality of information provided must be safeguarded.

(iv) Law enforcement authorities providing assistance to their foreign counterparts covering all financial crimes (not just those related to money laundering or drugs-related offences), extending to investigative assistance before court proceedings have been issued, and providing for evidence to be obtained on their behalf.

(v) OT regulatory authorities allowing information disclosed to a foreign regulatory authority to be disclosed in turn by them to a foreign law enforcement authority, but only with the OT's prior consent, which may extend to placing conditions on how that information might be used.

GATEWAYS: A PRECONDITION FOR INFORMATION EXCHANGE

4. Where confidential information is exchanged with a foreign authority, or between different authorities within the same jurisdiction, confidentiality should be safeguarded. Confidential information should only be exchanged where provided for in law. Confidential information should only be passed to *bona fide* authorities which can safeguard its confidentiality, and these safeguards should be established in law. Similarly, legislation in Overseas Territories should provide OT authorities with the power to safeguard the confidentiality of information they may have received from foreign authorities.

5. All Overseas Territories should have in place statutory 'gateways' which enable confidential information to be exchanged with foreign authorities. This would include all forms of information of interest to the authorities, including information relating to individuals, bank accounts, trusts, and companies. 'Gateways' legislation should override any secrecy and confidentiality provisions in OT law, to the extent that it should allow confidential information from all sources to be passed to a foreign authority, as long as that authority could in turn safeguard its confidentiality.

6. It is possible that foreign regulatory authorities might be compelled by Court order in their country to disclose confidential information obtained from an OT authority. In these circumstances, the OT authority's prior consent should be sought before any confidential information is disclosed to the Court. If such consent is not forthcoming, the Court should be made aware by the foreign authority that any compulsion to disclose may damage relations between regulatory authorities, to the detriment of future regulatory co-operation, and that this would not be in the public interest.

CO-OPERATION BETWEEN REGULATORY AUTHORITIES

(i) Types of co-operation

7. Gateways *per se* do not provide for adequate co-operation. They simply allow confidential information to be exchanged. Gateways need to be supplemented by powers which enable OT authorities to obtain information (either for their own purposes, or on behalf of foreign authorities), and subsequently to exchange this with foreign authorities.

(i) Supervisory information

8. OT regulatory authorities should be able to obtain, in the course of their normal duties, information relating to the supervision of licensed firms and persons. OT regulatory authorities should be able to exchange this information with their foreign counterparts.

(ii) Voluntary testimony

9. Representatives from a foreign regulatory authority should be allowed to visit an OT with the consent of the OT regulator, and take testimony from individuals and firms who voluntarily consent to being questioned by a foreign regulatory authority. Before approving a request to take voluntary testimony, the OT regulator should be satisfied (i) that the request comes from a *bona fide* foreign regulatory authority, and relates to their regulatory responsibilities, (ii) that the request relates to a specific line of investigation, and (iii) that the confidentiality of any information provided will be safeguarded.

(iii) 'Compulsory' powers

10. These are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT. Following discussions at the past three Attorney Generals' Conferences, a draft Model Ordinance providing for compulsory powers is now well developed (attached at Annex B).

11. Annex A provides more details on how these powers would operate in practice. Because individuals and firms are *compelled* to provide information, there are tight constraints and conditions on the use of these powers, and OT regulatory authorities would have discretion in deciding whether to use them on behalf of an overseas authority. It is worth noting here that;

(i) Compulsory powers should only be used in certain specific circumstances. Incoming requests for information, which will require the use of OT compulsory powers to obtain it, should be vetted by the regulatory authority's lawyers (or an OT Magistrate/Court) within a specific time frame, in order to verify that compulsory powers may be used. Information obtained by compulsion may also be vetted by the regulatory authority's lawyers before final disclosure to a foreign authority;

(ii) Information obtained by compulsion should not be used as evidence against the provider in any subsequent criminal proceedings. The OTs will wish to decide whether to preclude it being used as criminal evidence against third parties;

(iii) Compulsory powers are used only at the very early stages of an investigation, when the investigator does not know whether criminal activity is at hand. Compulsory powers should no longer be used if/when it becomes clear that only criminal activity is involved, and hence that the investigation should be taken forward by the law enforcement authorities (once a suitable request for assistance has been made through other channels);

(iv) Strict terms and conditions on the use of compulsory powers should ensure that they cannot be abused to go on 'fishing trips', that the Overseas Territories retain discretion over their usage, and that they should not be used when it would be more appropriate to go though other channels (eg Mutual Legal Assistance Treaties (MLATs)).

12. Subject to these conditions, information obtained by compulsion may be disclosed to the law enforcement authorities, who as a result may seek to obtain criminal evidence (via other channels). Information obtained by compulsion may help indicate where criminal evidence may be obtained, ie may lay the ground for further requests for assistance via other channels by foreign law enforcement authorities.

13. In summary, these powers are used to uncover facts during the very early stages of an investigation, before it is clear what has taken place, in order to gain a picture of what happened. When it has become clear what happened, the authorities may choose whether to take no action, whether to take disciplinary action, whether to consider civil proceedings, or whether to consider criminal proceedings. Criminal evidence would need to be obtained via other channels (ie agreements between law enforcement authorities) in order to pursue a criminal prosecution. In the UK's experience, compulsory powers are rarely used on behalf of a foreign authority (about ten times per year).

(ii) Memoranda of Understanding

14. It is common practice between regulatory authorities for the terms and conditions of information exchange and

investigative assistance to be set out in a Memorandum of Understanding signed between the authorities which will be co-operating with each other. Memoranda of Understanding usually require requests for assistance to be framed in terms of the specific activities which are being investigated by the foreign jurisdiction - eg they can prevent authorities going on 'fishing trips' in another jurisdiction.

15. Memoranda of Understanding should only provide for the exchange of confidential information when the foreign regulatory authority has demonstrated that they will be able to safeguard the confidentiality of information provided by the OT regulator. Memoranda of Understanding should specify explicitly how confidentiality will be safeguarded, and should set out the terms and conditions of onward disclosure, eg to a foreign law enforcement authority. It is common to allow a foreign regulatory authority to disclose information obtained (eg from an OT regulator) to another foreign authority, but only with the consent of the OT regulator in this example. Memoranda of Understanding should specify what terms and conditions apply to the use of compulsory powers, and this may include specifying how information provided may be used.

16. Memoranda of Understanding are not legally binding documents, nor are they any form of legislation. They are simply an agreement between two regulatory authorities. For this reason, they tend to be tailored to the degree and nature of assistance available in each jurisdiction. Separate MoUs tend to apply to each sector (ie banking, securities, and insurance), although eg an MoU in the securities field would still provide for the exchange of information on bank account details (where this was connected to a breach of regulations or laws concerning securities).

17. Further precise details on international standards relating to Memoranda of Understanding are set out in publications by the Basle Committee, IOSCO, and the IAIS. The IAIS paper 'Insurance Principles, Standards, and Guidance Papers' includes in an Annex a model MoU in the field of insurance. IOSCO have published separate guidance titled 'Principles for Memoranda of Understanding'.

18. An Overseas Territory regulatory authority may still exchange information with a foreign authority if a Memorandum of Understanding is not in place. The terms and conditions of such exchange would need to be agreed on a case by case basis. Memoranda of Understanding essentially provide a framework which allows information to be exchanged without the terms and conditions of such exchange having to be negotiated on each separate occasion. Memoranda of Understanding are therefore more relevant between jurisdictions which exchange regulatory information regularly.

CO-OPERATION BETWEEN LAW ENFORCEMENT AUTHORITIES

(i) Types of co-operation

19. Assistance should be available to foreign law enforcement authorities in relation to all forms of financial crime, rather than just drugs-related offences or money laundering. This would include fraud, insider-dealing, and market manipulation. An OT should be able to provide assistance even though the activity under investigation might not be a criminal offence in that OT. In these circumstances, OT law enforcement authorities will wish to consider whether there is a good reason to provide assistance, or whether it would be in the public interest not to provide assistance.

20. OT law enforcement authorities should be able to provide investigative assistance, and should be able to obtain evidence on behalf of their foreign counterparts. As with regulatory co-operation, assistance should be provided in response to specific requests. Investigative assistance should be made available before court proceedings have been issued, and ideally without the prior need for a Treaty to exist between the countries in question.

21. These objectives would be satisfied if the Overseas Territories were to adopt measures equivalent to those in the UK's Criminal Justice (International Co-operation) Act 1990, which provides for UK authorities to co-operate with judicial and prosecuting authorities in other countries in criminal proceedings and investigations. Many OTs have already introduced equivalent legislation. It is for OTs to decide whether they wish to satisfy the objectives specified here by adopting equivalent legislation or by choosing other means. It is worth noting here that assistance should be available to all *bona fide* foreign law enforcement authorities with genuine requests.

22. It is not common for Memoranda of Understanding to be signed between law enforcement authorities, if only because the types of co-operation required are often provided for by international Treaties. Nevertheless, there is nothing to prevent Memoranda of Understanding from being adopted, especially if OT law enforcement authorities wish to adopt bilateral agreements specifying exactly how assistance might be provided.

23. Memoranda of Understanding are generally easier and quicker to devise and modify than bilateral Treaties. For this reason, an OT is unlikely to be able to co-operate effectively in the ways envisaged with a wide range of countries over a

wide range of areas if it seeks to negotiate, sign, and manage a set of bilateral Treaties with all foreign law enforcement authorities which seek assistance.

(ii) Seizing assets

24. International co-operation should extend to tracing, freezing, and confiscating the proceeds of crime, and their value, on behalf of overseas authorities. Powers to trace assets for authorities in other jurisdictions should be exercisable regardless of banking secrecy and, preferably, on an agency to agency basis as well as through central authority channels. Powers to restrain and confiscate assets which represent the proceeds of crime should be on an all crimes basis, as envisaged in the 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime.

25. No assets should be immune from seizure, either by virtue of OT laws or other arrangements providing for asset protection, or by virtue of arrangements (eg in trust instruments) which require assets to 'flee' to another jurisdiction when there is a chance that they might be seized. These arrangements for asset seizure should apply to all financial crimes, ie not just drugs-related crimes or money-laundering, even though a crime may not have been committed in an OT.

CO-OPERATION BETWEEN DIFFERENT TYPES OF AUTHORITY

26. The G7 have recently adopted a set of ten principles concerning the extent to which regulatory and law enforcement authorities should work with each other, including when different types of authority are based in different jurisdictions. In general, different types of authority (regulatory and law enforcement) should be able to exchange information with each other and to provide each other with investigative assistance, subject to specific terms and conditions set out in Memoranda of Understanding. This does not imply that regulatory authorities should take on the role of 'international tax policemen'.

27. In practice, an OT regulatory authority would assist a foreign law enforcement authority by passing information to a foreign regulatory authority, and allowing them (with prior consent) to disclose this to a law enforcement authority in their jurisdiction. Domestic regulatory authorities do not tend to deal directly with foreign law enforcement authorities. If this arrangement is to work effectively, there need to be effective gateways and working relations between regulatory and law enforcement authorities in the same jurisdiction.

28. This should not, however, prevent OT regulatory authorities from dealing directly with foreign regulatory authorities which also happen to possess certain law enforcement and prosecuting responsibilities. In this instance, the Memorandum of Understanding between respective regulatory authorities would need to specify clearly how any information disclosed might be used.

ANNEX A: COMPULSORY POWERS (OR INVESTIGATIVE POWERS)

A1. Compulsory powers are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. In the context of regulatory co-operation, OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT.

A2. Compulsory powers may be used to obtain information from both licensed and unlicensed firms and persons. This includes ordinary members of the public as well as all financial institutions, companies, and trusts. Compulsory powers may be used to obtain all types of information, including details of beneficial ownership, personal bank details, and personal telephone records.

A3. Compulsory powers override all other secrecy and confidentiality provisions in law - ie they may be used to obtain information from bank accounts, companies, and trusts, even if other laws declare that all such information should not be disclosed. Confidential information would only be disclosed to a foreign regulatory authority if they could safeguard its confidentiality.

Use of compulsory powers

A4. These wide-ranging powers are used at the very early stages of an investigation to gain an understanding of what happened - ie which activities took place where, and who was involved with what. Compulsory powers are used infrequently, as regulatory authorities normally have a clear understanding of what happened, especially where 'know your customer' guidance is actively implemented and licensed firms and persons are willing to assist the authorities.

A5. Compulsory powers are used to undertake fact finding investigations, rather than to obtain criminal evidence. Information obtained by compulsion may be used by the regulator to take disciplinary or civil action. Because information is

obtained by compulsion, it cannot be used as evidence in criminal proceedings against the provider.

A6. Furthermore, the 'rules of evidence' which exist in most countries normally prescribe how evidence may be obtained, and this tends to involve questioning under police caution: ie the very nature of compulsory powers normally prevents any information obtained from being used as evidence in criminal proceedings. OT regulatory authorities may in addition wish to specify in Memoranda of Understanding signed with foreign counterparts that information obtained by compulsion cannot be used as evidence in criminal proceedings.

A7. Compulsory powers should not be used to provide assistance to a foreign regulatory authority if it would be more appropriate to use other channels (eg Mutual Legal Assistance Treaties (MLATs)). It is for the requested authority to determine the appropriate channels in line with commitments entered into in any MoUs or Treaties. In practice, compulsory powers should only be used when it remains possible that civil action may be taken as a result of the investigation at hand. As soon as it becomes clear during the investigation that the authorities are faced with only criminal activity, compulsory powers should no be longer used. At this stage, the law enforcement authorities should be left to pursue a criminal investigation (and overseas law enforcement authorities should seek assistance via other channels).

A8. Within this framework, compulsory powers can still be used to assist law enforcement authorities, but only at the very early stages of an inquiry, when it remains unclear what happened, and hence whether civil or criminal sanctions (or none) would be appropriate. Information obtained by compulsion essentially lays the ground for criminal investigations undertaken by law enforcement authorities, should it transpire that criminal activity is at hand. Compulsory powers would be used before a foreign law enforcement authority is in a position to make a request for assistance from an OT law enforcement authority (eg via MLAT).

A9. In this limited sense, the use of compulsory powers may lead to criminal prosecutions. In practice, an OT regulatory authority would not deal directly with a foreign law enforcement authority. Instead, OT regulatory authorities would deal with their foreign counterparts, and then allow (with prior consent) their foreign counterparts to disclose information received to foreign law enforcement authorities.

Who investigates?

A10. Investigations are usually undertaken by the domestic regulatory authority on behalf of the overseas regulator. It is normal for these powers to be vested with the head of the regulatory authority, although an alternative may be to vest them with the Governor or Minister of Finance (depending on who is ultimately responsible for regulation of the offshore sector).

A11. Whoever holds these powers may authorise an officer of his or any other competent person to exercise them. If an OT so wishes, it is possible for an OT regulator to allow an overseas regulator to operate as an authorised agent of theirs and use these powers directly. The decision on who to appoint is normally made on a case by case basis.

A12. Payment of the costs of exercising these powers can be made a condition for providing assistance. This normally happens when the balance of requests tends to be one-sided, rather than domestic and overseas authorities seeking broadly equivalent assistance from each other.

Constraints and discretion in exercising compulsory powers

A13. The exercise of investigative powers after a request is not inevitable, nor is the disclosure of information obtained by their exercise. The powers can only be used to assist an overseas authority having specified regulatory functions, and then only for the purposes of those functions. Assistance should be provided when there is a good reason to do so (this hurdle is normally relatively easy to satisfy).

A14. The information which is obtained through the exercise of investigative powers can be disclosed only if a gateway exists. If there are concerns about how the confidentiality of the information provided will be safeguarded once in the hands of the overseas regulator, or if, as a result of the investigation, doubts have arisen about the authenticity of the overseas regulator's claim to need the information for its regulatory functions, the OT regulatory authority should discuss its concerns with the foreign regulatory authority before disclosing any information.

A15. Assistance should be provided in response to individual requests, which should specify what information is sought and the purpose for which it is sought, including details of the laws, rules or regulations which it is alleged have been breached and of the conduct which gives rise to the breach. The draft model OT Compulsory Powers Ordinance (attached) requires that the following factors be taken into account when deciding whether to exercise compulsory powers on behalf of a foreign authority;

Whether corresponding assistance would be given to the OT;

Whether the inquiries relate to a breach of law which has no parallel in the OT (although assistance may still be provided in these circumstances, if there is a good reason to do so);

The seriousness of the matter in question, the importance to the investigation of exercising compulsory powers, and whether assistance could be obtained by other means (eg MLATs);

Whether it is in the public interest to provide assistance.

A16. Each request for assistance should be vetted by the OT regulatory authority to ensure that it is made by a foreign authority which has the necessary functions and that the request is made for the purpose of its regulatory functions. The requesting authority must demonstrate that a substantial line of enquiry is being pursued - its request should not be a "fishing trip" for information. In practice, the OT regulatory authority would also vet all information obtained by compulsion, to ensure that information disclosed to a foreign authority relates to the specific request made. This vetting would normally be undertaken by the OT regulatory authority's legal advisers. The draft model OT Compulsory Powers Ordinance also provides for an OT Magistrate or Court to approve the use of compulsion, within a short time frame. Under the draft model OT Compulsory Powers Ordinance, it is a criminal offence not to provide information under the exercise of compulsory powers.

ANNEX B: DRAFT COMPULSORY POWERS MODEL ORDINANCE

A Bill entitled:

An Ordinance to make provision for assisting overseas regulatory authorities to obtain information:

ENACTED BY the Legislature of [the Caribbean Overseas Territory] as follows:

1. This Ordinance may be cited as the ******** Ordinance, 1998.

2. In this Ordinance:

"competent authority" means any authority specified in [the Schedule to this Ordinance] [an Order made by the Governor];

["Director" means the Director of Financial Services;]

"foreign regulatory authority" means an authority which, in a country or territory outside [the Caribbean Overseas Territory], exercises functions corresponding to any functions of a competent authority under any Ordinance, or exercises any function [prescribed for the purposes of this section by an Order made by the Governor, being a function] which in the opinion of the Governor relates to companies or financial services;

"Governor" means the Governor in Council;

"regulatory functions" means functions of a competent authority under any Ordinance or any functions corresponding to such functions, and any other functions relating to companies or financial services, not being the functions of assessing, imposing or collecting taxes.

3. (1) Subject to subsection (2), the powers conferred by section 4 are exercisable by the [Director] for the purpose of assisting a foreign regulatory authority which has requested assistance in connection with inquiries being carried out by it or on its behalf.

(2) The [Director] shall not exercise the powers conferred by section 4 unless he is satisfied that the assistance requested by the foreign regulatory authority is for the purposes of its regulatory functions.

[(2A) The [Director] may decline to exercise the powers conferred by section 4 unless he is satisfied that information furnished pursuant to the exercise of those powers will not be used in any criminal proceedings against the person furnishing it (other than proceedings for an offence under section 7 or for an offence of perjury, or for any like offence).]

(3) In deciding whether to exercise those powers, the [Director] may take into account, in particular:

(a) whether corresponding assistance would be given in the relevant country or territory to an authority exercising regulatory functions in [the Caribbean Overseas Territory];

(b) whether the inquiries relate to the possible breach of a law, or other requirement, which has no close parallel in [the Caribbean Overseas Territory] or involves the assertion of a jurisdiction not recognised by the [the Caribbean Overseas Territory];

(c) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in [the Caribbean Overseas Territory] and whether the assistance could be obtained by other means;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

[(4) For the purposes of subsection (3)(a), the [Director] may require the foreign regulatory authority requesting assistance to give a written undertaking, in such form as the [Director] may determine, to provide corresponding assistance to an authority exercising regulatory functions in [the Caribbean Overseas Territory].

(5) Where a foreign regulatory authority fails to comply with a requirement made under subsection (4), the [Director] may refuse to provide the assistance sought.]

(6) The [Director] may decline to exercise the powers conferred by section 4 unless the foreign regulatory authority undertakes to make such contributions towards the costs of their exercise as the [Director] considers appropriate.

(7) In subsection (3)(a), "relevant country or territory" means the country or territory from which the request for assistance is made.

4. (1) Where in accordance with section 3 the [Director] is satisfied that assistance should be provided pursuant to a request by a foreign regulatory authority, he may in writing direct any person -

(a) to furnish him with information with respect to any matter relevant to the inquiries to which the request relates;

(b) to produce any documents relevant to those inquiries; or

(c) to give him such assistance in connection with those inquiries as the [Director] may specify.

[(3) The [Director] may examine a person on oath and may administer an oath accordingly.]

[(3A) Where a person fails to comply with a direction given under subsection (1) within three days from the date of the direction or such longer period as the [Director] may permit, the [Director] may apply to [a Magistrate] [the court] for an order requiring the person to comply with the direction.

(3B) Where pursuant to a direction given under subsection (1) the [Director] considers it necessary to examine a person on oath, [the Director] may apply to [a Magistrate] [the court] to have that person examined by [the Magistrate] [the court] and the results thereof transmitted to the [Director].

(3C) [A Magistrate] [the court] shall process an application under subsection (3A) or (3B) within seven days and, in the case of subsection (3B), [he] [it] shall transmit the results of the examination to the [Director] within a reasonable period not exceeding fourteen days.]

(4) Where documents are produced pursuant to this section the [Director] may take copies or extracts from them.

(5) A person shall not under this section be required to disclose information or produce a document which he would be entitled to refuse to disclose or produce on grounds of legal professional privilege in proceedings, except that a [lawyer] [barrister or solicitor] may be required to furnish the name and address of his client.

(6) Where a person claims a lien on a document, its production under this section is without prejudice to his lien.

(7) In this section "documents" includes information recorded in any form; and, in relation to information recorded otherwise than in legible form, the power to require its production includes power to require the production of a copy of it in legible form.

5. (1) The [Director] may:

(a) [seek the assistance of the Commissioner of Police in the exercise of his powers under this Ordinance; or]

(b) authorise an officer of his or any other competent person to exercise any of those powers.

(2) No such assistance shall be sought or authority granted except for the purpose of investigating -

(a) the affairs, or any aspect of the affairs, of a person specified by the [Director]; or,

(b) a subject matter specified by the [Director];

being a person who, or a subject matter which, is the subject of the inquiries being carried out by or on behalf of the foreign regulatory authority.

(3) No person shall be bound to comply with a requirement imposed by a person exercising powers by virtue of an authority granted under this section unless he has, if required, produced evidence of his authority.

(4) Where the [Director] seeks assistance or grants an authority under subsection (1), the assistance or authority shall be provided or executed in such manner as the Director may determine; and where the Director grants such an authority to a person other than one of his officers, that person shall make a report to the [Director] in such manner as he may require on the exercise of that authority and the results of exercising it.

6. (1) No information which

(a) is supplied by a foreign regulatory authority in connection with a request for assistance, or

(b) is obtained by virtue of the exercise of powers under this Ordinance, shall, except as permitted by subsection (2), be disclosed for any purpose by the primary recipient, or by any person obtaining the information directly or indirectly from him, without the consent of the person from whom the primary recipient obtained the information and, if different, the person to whom it relates.

(2) Information to which subsection (1) applies may be disclosed:

(a) to any person with a view to the institution of, or otherwise for the purpose of:

(i) criminal proceedings;

(ii) disciplinary proceedings relating to the exercise by a barrister, solicitor, auditor, accountant, valuer or actuary of his professional duties;

(iii) disciplinary proceedings relating to the discharge by a public [servant] [officer] of his duties;

(b) for the purpose of carrying out any duty imposed under any law in force in [the Caribbean Overseas Territory] or by any international agreement to which [the Caribbean Overseas Territory] is a party;

[(c) on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings;]

(d) for the purpose of enabling or assisting a competent authority to discharge any of its functions under any Ordinance;

(e) to the [Governor/Attorney General/public officer approved by the Director] [in the public interest];

(f) if the information is or has been made available to the public from other sources;

(g) in the form of a summary or collection of information framed in such a way as not to enable the identity of any person to whom the information relates to be ascertained;

(h) to a foreign regulatory authority for the purpose of its regulatory functions.

(3) In subsection (1) "the primary recipient" means, as the case may be -

(a) the [Director];

(b) any person authorised under section 5; or

[(c) the Commissioner of Police or any of his officers.]

7. (1) A person who

(a) without reasonable excuse, refuses or fails to comply with any [direction given by the [Director]] [order of [a Magistrate] [the court]] under section 3;

(b) intentionally furnishes false information in purported compliance with any such [direction] [order];

(c) with intent to avoid the provision of this Ordinance, destroys, mutilates, defaces, secretes or removes any document;

(d) otherwise wilfully obstructs any inquiry to which a request from a foreign regulatory authority relates; or

(e) contravenes section 6;

commits an offence.

(2) A person who commits an offence under this section is liable .....

8. No suit shall lie against the [Director] or any person acting under his authority for anything done by him, in good faith, in the exercise of any power or the performance of any function under this Ordinance.

9. This Ordinance shall come into [force] [operation] on such date as the Governor may by proclamation appoint.

MONEY LAUNDERING

INTRODUCTION

1. Money laundering is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises. It is, in effect, the interface between the illegal business sector and the financial sector. Estimates of the size of the phenomenon are hard to come by, but it is generally agreed that it could be in the region of 5% of GDP of the average country.

2. The activity is one of considerable concern for many reasons. If the proceeds of crime are allowed to be lodged unhindered in financial institutions, criminals can gain influence over the institutions and, perhaps eventually control them. Where criminal proceeds are used to buy legitimate businesses, competitors find themselves unable to compete and are driven out of business. Unchecked, money laundering can destabilise financial institutions, sectors and, in certain cases, entire economies. Economic crime can damage financial markets and, thus, the reputation and health of a nation as a whole. It is the concern generated by these implications that have galvanised the international community into making concerted efforts to tackle money laundering.

3. These efforts are highlighted by the following initiatives:

* the 1988 UN Drugs Convention requires parties to criminalise drug money laundering;

* the Financial Action Task Force (FATF) set up in July 1989 by the G7 specifically to develop and promote policies to combat money laundering.

* the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime November 1990;

* the EC Money Laundering Directive of June 1991 requires Member States to prevent the use of their financial systems for money laundering;

* the Caribbean Financial Action Task Force (CFATF) the first regional body to follow the FATF.

4. The White Paper on Britain and the Overseas Territories (Partnership for Progress and Prosperity) noted that the Caribbean Overseas Territories are, in particular, a potential target for money launderers. The OTs should, therefore, have in place comprehensive measures to combat money laundering.

5. The White Paper checklist acknowledged, however, that this is an area in which the OTs have already made good

progress. Most have now introduced "allcrimes money laundering legislation". This legislation must, however, be enforced and reviewed regularly. To their credit, all of the OTs are members of the Caribbean Financial Action Task Force and either have, or will shortly undergo, mutual evaluations.

6. The following guidance explains what HMG means by "comprehensive measures to combat money laundering".

INTERNATIONAL STANDARDS

The FATF 40 Recommendations:

7. The 40 Recommendations set the basic framework for anti-money laundering efforts and are designed to have universal application. The principles cover the criminal justice system, law enforcement, the financial system and its regulation and international co-operation. The essential components of the 40 Recommendations are as follows:

* Each country should implement a general framework which ratifies the Vienna Convention, and increases multilateral co-operation on money laundering cases.

* Each country should criminalise money laundering in relation to serious offences, not merely drug money laundering.

* Countries should also put in place measures to enable the tracing, freezing and seizing of criminal assets and the ultimate confiscation thereof.

* The following should be required of all financial institutions, whether they be bank or non-bank institutions:

customer identification "know your customer"

record keeping 5 years

special attention to complex/unusual/large transactions

immunity from prosecution if report suspicion in good faith

internal systems including training and designation of compliance officer

application of these requirements to foreign branches

* Each country should improve spontaneous or "upon request" international information exchange relating to suspicious transactions. This requirement is subject to strict safeguards necessary to ensure consistency with national and international provisions on privacy and data protection.

* Different definitions and standards between jurisdictions should not affect the ability or willingness of countries to provide each other with mutual legal assistance.

* There should be procedures regarding the use of compulsory measures including the production of records by financial institutions.

OTHER RELEVANT STANDARDS

CFATF additional 19 Recommendations:

8. In June 1990 representatives of Caribbean and Latin American States formulated a further 19 Recommendations specifically tailored to regional laws and circumstances. These acknowledged the need to devote adequate resources to this area, the need for competent authorities to specialise in it and that improvements would be ' required to legal systems to enhance the regulation and the role of the financial sector and to improve international co-operation. In particular the CFATF Recommendations urged members to:

* consider the practical evidentiary complications of limiting money laundering to only certain predicate crimes.

* criminalise conspiracy and/or aiding or abetting drug trafficking and money laundering offences.

* to consider making money laundering an offence both where the offender knew or ought to have known the origin of the funds.

* to make money laundering an offence no matter where the predicate offence took place.

* to acknowledge that the fact that a financial adviser is an attorney is insufficient reason to invoke attorneyclient privilege.

EU Money Laundering Directive:

9. Although this has no direct impact on the OTs, it is relevant in so far as it informs the UK law. The EU Money Laundering Directive of 10 June 1991 (91/308/EEC) requires Member States to prevent the use of their financial systems for money laundering. The EU suggests three main steps to combat money laundering: criminalise it; take measures to identify laundered proceeds with a view to confiscation; pass laws and establish systems to prevent the proceeds of crime being laundered in the first place.

10. The Directive also sets out requirements to be placed on the credit and financial institutions (as defined) of the Member States' jurisdictions. This includes customer identification and retention of records, relating to identification and transactions, for a period of five years. The Directive goes on to require Member States to place a requirement on such institutions to inform the authorities about suspected money laundering activity.

The UK law and practice:

11. The UK implemented the EU Directive by means of the Criminal Justice Act 1993, the Money Laundering Regulations 1993 and earlier legislation. The principal money laundering offences are set out in the Prevention of Terrorism (Temporary Provisions) Act 1989 and the Drug Trafficking Act 1994. The Criminal Justice Act 1988, as amended, contains the money laundering offences relating to the proceeds of crimes other than drug trafficking and terrorism. These are defined as all indictable offences, other than those covered by the 1989 and 1994 Acts, plus the summary offences set out in Schedule 4 to the 1988 Act. The latter include certain lucrative offences relating to sex establishments and the supply of unclassified videos.

12. The principal money laundering offences have a dual purpose. Firstly, to criminalise and so suppress money laundering activity. Secondly, to encourage the reporting of suspicious transactions to the authorities. In this second respect, the offences help to protect the integrity of financial institutions by deterring criminals from lodging proceeds in them, and also help to provide the police with new investigative leads.

Criminal Justice Act 1988, as amended by the Criminal Justice Act 1993:

13. The money laundering offences created by this legislation are as follows:

Assisting another to retain the proceeds of crime: to commit this offence, one must know or suspect that the person in question is or has been engaged in crime, or has benefited from it.

Acquiring, Possessing or using another's proceeds of crime: the offence only applies where the launderer acquires, possesses or uses the property for inadequate "consideration,' (payment). Thus, if one pays full value for the property one does not commit the offence. The provision of goods or services which are of assistance in criminal conduct is not regarded as "consideration".

Concealing another person's proceeds of crime: This includes concealing or disguising property; or converting or transferring property or removing it from the jurisdiction. Carrying out these activities must be for the purpose of assisting somebody to avoid prosecution for a relevant offence or the making of a confiscation order against him/her. Unlike the above offences, all that is required here is "reasonable grounds for suspicion". Thus the prosecution need only prove that the person laundering the proceeds **should have suspected.**

Laundering one's own proceeds: This includes the same activities as concealing another person's proceeds and one must conceal, disguise, convert, transfer or remove property from the jurisdiction for the purpose of avoiding one's own prosecution for a relevant offence or the making of a confiscation order against oneself.

14. The penalties for all of the above offences are fourteen years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction (currently £5,000).

15. The legislation also includes the following offences:

Tippingoff offences: These apply when a money laundering investigation is being, or is about to be, conducted, and where a suspicious transaction report has been made, or a suspicion of money laundering has been disclosed to the authorities. The

offence can be committed where one knows or suspects that an investigation is being conducted, or is about to be, or a disclosure has been made.

16. The penalties for tippingoff are five years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction.

The Money Laundering Regulations 1993:

17. Another essential part of the UK's antimoney laundering defences are the Money Laundering Regulations. They require financial institutions to put in place systems to deter money laundering and to assist the authorities to detect money laundering activities. The Regulations apply to:

* all banks, building societies and other credit institutions,

* all individuals and firms authorised to conduct investment business under the Financial Services Act 1986,

* all insurance companies covered by the EC Life Directives, including the life business of Lloyds of London,

* all other undertakings carrying out any of the range of financial activities listed in the annex to the Second Banking Directive (89/646/EEC, SI 1992,3218). This includes bureaux de change and money transmission services.

18. The Regulations establish criminal offences for those who fail to ensure adequate systems are in place and maintained. Thus, the Regulations require:

* procedures to ensure identification of customers, maintenance of records relating to identification and transactions, or such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering;

* appropriate measures to be taken from time to time to make employees who handle relevant financial business aware of the procedures and the money laundering statutes;

* provision of training for those employees from time to time in the recognition and handling of transactions which may be money laundering.

19. Where an offence is committed by a body corporate, partnership or unincorporated association, the directors and managers and certain other people may be guilty of the offence as well. Penalties for contravention of the Regulations are two years imprisonment and an unlimited fine on indictment and a fine not exceeding the statutory maximum on summary conviction.

Money Laundering Guidance Notes:

20. In addition to the above, the British Bankers Association have produced guidance notes for the industry in association with the Building Societies Association and the law enforcement authorities. Similar guidance notes have also been produced for the insurance and investment business sectors.

COMPLIANCE WITH THESE STANDARDS

21. With regard to the OTs, we have encouraged the OTs to put in place measures equivalent to those in the UK. Most have now implemented the primary legislation. However, work on the essential supporting measures still needs to be completed.

Regulations:

22. Many OTs have opted to implement voluntary codes of practice rather than an equivalent to the UK Money Laundering Regulations 1993 (the Regulations). **To be effective these need to be placed on a statutory footing** providing for criminal offences in the event that monitoring and reporting systems are not created and maintained.

23. Effective operation of the antimoney laundering legislation relies on the vigilance of financial institutions and the reporting of suspicious transactions. While the requirement to put in place monitoring and reporting systems is voluntary, the risk of commercial interest frustrating the intent is concrete. Placing these requirements on a mandatory footing would enable the OTs to ensure that the supporting mechanisms for their money laundering defences could be enforced. It would also send a clear signal to the financial sector that "all money is not simply money", and that certain types of financial activity were unacceptable.

Resources and enforcement:

24. It is clear from the above that the creation of anti-money laundering defences requires considerable input of resources on the part of the financial institutions. This, however, is only one part of the equation. There is little point in requiring the financial sector to report suspicious transactions if there is an inadequate ability on the part of law enforcement to respond. This means that OT Governments must devote considerable resources to ensuring that the law enforcement capacity for analysing suspicious transaction reports and, where appropriate, acting on them is sufficient. This will apply not only to reports submitted by institutions operating within the jurisdiction, but also to requests for assistance on money laundering investigations from foreign jurisdictions. It is, therefore, essential that the Financial Investigation and Intelligence Units in the OTs are adequately staffed with trained personnel capable of conducting financial investigations and analysis.

25. In addition, it will also be necessary to ensure that the Attorney Generals' Chambers and the judiciary in each OT are appropriately resourced and trained to handle the types of cases which may result from enforcement of the money laundering laws. Again, this relates not merely to prosecutions of offences within the OTs, but also to provision of assistance to foreign jurisdictions in pursuance of the antimoney laundering legislation. Where appropriate, HMG is willing to provide assistance on a short term basis. However, it will be for the OTs to ensure that they budget appropriately for these responsibilities in the future.

International co-operation and confiscation:

26. It goes without saying that a great deal of money laundering involves transactions spanning a number of jurisdictions. The more complex the transactions and the more jurisdictions involved, the harder it is for law enforcement to follow the money trail. The abolition of exchange controls in the late seventies and early eighties, and the rapid improvement in technology means that it is possible instantly to transfer money of any amount or denomination virtually anywhere in the world. Much criminal law is territorially based, and differs from jurisdiction to jurisdiction, so the investigation and prosecution of financial crime and money laundering are very dependent upon mutual legal assistance between states.

27. The confiscation and money laundering legislation which the OTs have been enacting enables many of them to co-operate in international asset tracing investigations, and in the restraint and confiscation of the proceeds of drug trafficking and other crime. Given the percentage of financial business in the OTs which has its origins in other jurisdictions, it is vital that these provisions for international cooperation are fully implemented and, when implemented, operate effectively. At a time when much attention is being focused internationally on offshore centres, it is in the OTs interests to ensure their reputation for being willing and able to assist in tracing, freezing and confiscating criminal proceeds is second to none.

28. HMG is mindful of OT concerns that they may invest considerable resources in providing investigative assistance in proceeds of crime cases, only for the assets to be confiscated elsewhere and retained by the confiscating jurisdiction. In our view, international asset sharing from which some OTs have benefited considerably in recent years provides the best way to ensure that the costs of international casework is shared equitably among cooperating jurisdictions. we strongly support the sharing of confiscated assets relating to all crimes, including drug trafficking, and are working internationally to promote progress in this area. We are happy to discuss continuing concerns about costs with the OTs, and have asked them whether they would be interested in having the Council of Europe Convention extended to their jurisdictions.

Fiscal offences:

29. International standards indicate that money laundering should be criminalised in relation to all serious crime, not merely drug trafficking. The principles leave the definition of serious crime to the individual jurisdictions. At the same time, however, **they also make it clear that such individual definitions should not affect the ability "or willingness" of countries to provide mutual legal assistance.**

30. In the UK we treat tax evasion as a serious crime so it is caught by our confiscation and money laundering legislation. We are aware that different jurisdictions treat specific tax offences in different ways. Experience suggests that this can create problems where money laundering investigations relate in some way to tax offences.

31. The "tax issue" can arise in two ways. First, the predicate offence to which the money laundering offence relates is a tax offence. Assume the predicate offence takes place in jurisdiction A and the money laundering offence takes place in jurisdiction B. A problem is created where the latter does not recognise the tax offence in question as a predicate offence to which its money laundering legislation applies. As a result it will not provide co-operation to jurisdiction A in its investigations. Second, the predicate offence may be another serious crime, such as drug trafficking. It is, however, disguised as a tax related problem to ease the process of laundering. Nonrecognition of tax offences, or non-cooperation on money laundering cases involving such offences can frustrate all sorts of criminal investigations. In either of these scenarios, the

inability to cooperate where tax is, or appears to be, involved creates a loophole in the anti-money laundering defences which criminals will utilise.

32. Failure to provide adequate coverage for this issue in the antimoney laundering defences has two serious drawbacks. it makes it easier for criminals to get away with tax evasion, which we regard as a serious crime, and it undermines efforts to combat other forms of offending.

33. There is some concern that the inclusion of tax offences as predicate offences, for the purposes of the money laundering legislation, will place a requirement on financial institutions to know and understand the fiscal regimes in other jurisdictions. This is quite wrong. Under the money laundering offences one is only required to consider whether one has a suspicion of something which would be a crime in one's own jurisdiction. it is also argued that it is difficult or impossible to determine whether a transaction is indeed linked to drug trafficking, tax or any other specific crime. However, the financial institutions and their employees are not expected to investigate suspicions, but to disclose them. As noted above, in the case of the UK, this includes disclosing suspicions of tax evasion. It is worth noting, however, that cooperation on money laundering investigations involving tax offences does not necessarily require such offences to be made predicate. There may be other related offences which fall within the ambit of a jurisdiction's money laundering legislation.

34. There is also an argument that "there is no such thing as the laundering of money from tax fraud', on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime.

35. The UK's confiscation, money laundering and judicial co-operation legislation enables us to trace, freeze and confiscate the proceeds of tax evasion, or any other crime, on behalf of other jurisdictions. Where restraint and confiscation are concerned, the conduct overseas must correspond to an applicable offence in the UK. **However, much investigative assistance can be provided without any dual criminality requirement.** We can, and do, assist in foreign tax evasion cases, including cases where the conduct is not necessarily an

offence in the UK.

36. As part of the efforts to combat money laundering, the UK is encouraging others to close loopholes. We would, therefore, encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able.

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3 (Copies of Guidance Notes to be provided to Consultants.) Back

4 Clive Briault: *The Rationale for a Single National Financial Services Regulator* - May 1999 Back

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Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda — The British Virgin Islands

1 Executive summary

1.1 Introduction

This is one of six reports we have issued covering the Caribbean Overseas Territories and Bermuda. This report deals with the British Virgin Islands.

The British Virgin Islands ("the BVI") is a British Overseas Territory some 153 square kilometres in size and comprising over 40 islands, islets and cays. It has been a British territory since 1672. The population of the BVI at the last census in 1997 was 19,107. Its GDP per capita in 1997 was US$28,434. Its estimated growth rate for 1998 was 6.81%.

Constitutionally, the BVI enjoys a large measure of self-government as an internally-governing Overseas Territory. Government is undertaken through a Governor who is appointed by the Crown, and through Executive and Legislative Councils. The Governor retains direct responsibility for internal security, external affairs, defence, the public service and the administration of the courts but not financial services. Elections are held at least every four years.

1.2 Financial services in the BVI

Financial services are the main element of the BVI economy and account for approximately half of government revenues. The financial services sector has been growing rapidly in recent years.

The BVI are one of the world's largest centres for the incorporation of companies, particularly international business companies ("IBCs"). It is believed to have a dominant 45% share of the global market. The BVI also offers other financial services, particularly in the areas of banking, insurance, trusts and mutual funds.

By 31 December 1999, 9,561 Companies Act companies (primarily conducting local business) and 358,054 IBCs (conducting offshore business) had been incorporated. Approximately 250,000 IBCs are still active, the balance having been liquidated or struck off the Register.

The BVI are also a major jurisdiction for the incorporation of mutual funds. As of February 2000 there were 139 public funds and 1,545 non-public funds. The regulator in the BVI, the Financial Services Department ("FSD") does not have details of the size of funds under management as there is no requirement to report fund size.

The BVI does not actively encourage applications for banking licences. This is reflected in the scale of the sector. As at the end of December 1999, there were 13 authorised banking institutions in the BVI, with total assets of some US$2.7 billion.

The BVI's prominent insurance sector is in the offshore captive market. There are 131 captive insurance companies and 59 credit life reinsurance captives. Three companies registered in the BVI are licensed to undertake third party business, but this type of licence is no longer issued.

Statistical information on the insurance market is not available. Total gross premium income is estimated by the insurance commissioner to be US $200-300 million annually.

In respect of securities/investments business, only administrators and managers of mutual funds are currently regulated. As at 1 March 2000, 289 mutual fund administrators and managers had been licensed. No data is available as to the extent of investment/securities activities being undertaken on an unregulated basis (for example dealing or arranging deals in investments).

As at 31 March 2000 there were 17 licensed company managers. However, the FSD estimates that approximately 60 trust companies also carry on some form of company management business.

As in most other jurisdictions, there is no requirement to register trusts in the BVI or for them to produce audited accounts. Accordingly the level of trust activity is unknown.

70 international limited partnerships have been registered.

1.3 **Financial services regulation**

The responsibility for the overall licensing, regulation and supervision of financial activities in the BVI is vested in the Governor in Council (that is, the Governor acting with advice of the Executive Council of the Territory save as is otherwise provided under the Constitution) and the Minister of Finance.

The Governor in Council is responsible for all licensing, revocation of licences and enforcement decisions relating to regulated firms. In the case of mutual funds, the Governor in Council is responsible for licensing public funds and the Minister of Finance for recognising non-public funds.

The day-to-day regulation of offshore financial business is undertaken by the FSD which includes the company registry.

The FSD is staffed with a Director, Deputy Director and 57 other employees, the majority of whom are involved with the registry section. Of those assigned directly to the regulation of financial institutions, four are assigned to banks, trust companies and company managers, four to the insurance sector and five to mutual funds. The heads of these departments are the Inspector, the Commissioner and the Registrar respectively.

There is legislation in place covering the regulation of banking (both domestic and offshore), insurance (both domestic and offshore), mutual funds, including their management and administration, company service providers and trust service providers. There is no specific regulatory legislation relating to securities/investment business other than in connection with mutual funds.

1.4 **Summary of principal findings**

1.4.1 **Introduction**

The following represents a summary of our findings, and represents only the key issues arising from our review. As such, this section should be read in conjunction with the Report as a whole.

1.4.2 **Regulatory authority**

In our view the FSD appears to be a well-run regulator with a strong commitment to achieving international standards. However, we do not consider the current regulatory structure to be fully in accordance with international standards. This is because the current position by which the Governor in Council (or Minister of Finance) is responsible for licensing and enforcement action relating to financial service activity means that the regulator is not operationally independent. We, therefore, recommend that the FSD should become an independent regulatory body and that the current powers exercised by the Governor in Council, Minister of Finance and the individual regulators are transferred to that new body.

In addition, we consider that two further matters need to be addressed in order for the regulatory structure to be in a position to meet international standards. First, we consider that there should be an increase in staffing resources, particularly in relation to the area of mutual fund supervision. Secondly, we recommend that the marketing role of the FSD is transferred to another body.

1.4.3 **Banking**

The BVI has a conservative approach to banking. This is evidenced by the BVI's policy of not encouraging banking licence applications, combined with the fact that the BVI does not act as consolidated regulator of any bank. This means that a number of Basel standards relating to banking supervision are inapplicable.

We consider that the BVI is committed to continuing to improve the quality of its banking supervision. However, we concur with the view of the Director of Financial Services that additional work needs to be undertaken to bring the regulation of banking in the jurisdiction fully into line with international standards.

Three key areas for improvement are being addressed by the BVI. These are the establishment of on-site supervision, the enhancement of off-site supervision and the current failure by one licence holder to meet the necessary Basel minimum capital requirement.

A number of other areas need to be addressed. The principal ones are:

- that the Development Bank of the Virgin Islands should come under regulatory supervision;
- the provisions for obtaining information from licence holders and sharing information with overseas regulators

should be improved, if necessary through legislative amendment; and

- auditors of banks should be subject to regulatory approval.

1.4.4 **Insurance**

Whilst the BVI has an acceptable legislative basis for the regulation of insurance companies, there are a number of areas that should be addressed.

We consider that the following improvements will help address the principal areas of weakness:

- full statistical information should be obtained and companies must be required to provide information on essential market data including premiums, reinsurance and loss ratios;
- on-site inspections should be introduced;
- the Commissioner should be granted further enforcement powers; and
- guidance notes should be issued in key areas.

1.4.5 **Securities/investments**

The introduction of a regulatory regime for the managers of mutual funds is positive evidence of the BVI's commitment to move towards full compliance with international standards. It should also be noted that, unlike a number of other jurisdictions, the BVI treats fund administration as a regulated activity. We consider this approach to represent good practice.

The FSD accepts that, despite these efforts, the current regulation of securities/investment business in the BVI fails to meet fully the international standards set out by the International Organisation of Securities Commissions ("IOSCO"). This is principally due to the absence of legislation covering investment business other than in respect of the management of mutual funds.

In addition, there are other deficiencies which need addressing. The principal areas are:

- the need to establish on-site and off-site supervision;
- the lack of a regulatory code for licence holders; and
- the need for an increase in the enforcement powers of the Registrar of Mutual Funds.

It should be noted that the BVI is aware of these weaknesses and is developing plans to rectify them.

1.4.6 **Mutual funds**

The establishment of a legislative and regulatory regime in 1998 has significantly improved the BVI's level of supervision of mutual funds. This legislation was particularly important because of the number of BVI companies which are acting as mutual funds.

Whilst the legislation was introduced later than in a number of other leading offshore centres, it nevertheless contains a number of provisions which significantly assist the BVI in moving towards achieving international standards in the regulation and supervision of mutual funds.

There are, however, some areas where improvements are needed to meet IOSCO Principles. These primarily relate to:

- the enhancement of off-site monitoring;
- the introduction of on-site inspection;
- the introduction of regulation for public funds; and
- further enforcement powers for the Registrar of Mutual Funds.

1.4.7 **Companies**

We have not undertaken a thorough review of the Companies Act or the International Business Companies Act as this is

beyond our Terms of Reference ("TOR"). Therefore, our specific comments and suggestions in this Report concerning the CA and the IBC Act should not be taken as the only amendments that may be required. We have, however, reviewed those aspects of the legislation that bear directly on our TOR and have taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

From our review it is clear that the CA is out of date. We are advised that it is based on the old UK Companies Act 1929. The CA lacks many of the features found in a modern piece of companies legislation. Based on our overview, we consider that the CA is in need of review. It falls short of what one would expect of a modern piece of corporate legislation.

We are of the view that the IBC Act is also in need of review as it does not comply with good practice standards.

In addition to the above, our principal recommendations in this area are:

- the "immobilisation" of bearer shares;
- the introduction of a capability to disqualify a person from acting as director of a BVI company;
- that the names of directors should form part of the publicly available information held at the companies registry; and
- that the enforcement powers under the Companies Act and the IBC Act be increased to include the ability of the Registrar to initiate an investigation into a company and to petition the courts to wind up a company in the public interest.

The issue of bearer shares is particularly important. Measures should be introduced whereby:

- the regulator can, where necessary, find out the ownership (through the licence holder);
- there are adequate legal powers to require this information to be kept and disclosed; and
- in appropriate cases it can then be passed, as indeed can other company information not concerned with bearer shares, to regulators in other jurisdictions, through "gateways".

1.4.8 **Company service providers**

The BVI has in place a number of regulatory provisions relating to the supervision of those engaged in company service provision. We consider this to be a positive feature of the BVI regulatory structure and one that exists only in a limited number of other jurisdictions.

At present additional features are required to bring regulation in the BVI fully in line with international good practice.

We have also made a number of other recommendations designed to reduce the potential for companies to be used for money laundering, fraud or other illegal purposes. The principal ones of these are:

- that the current exemptions granted under the legislation to persons who only carry on certain functions (for example, the provision of directors) are removed;
- the provision of greater enforcement powers for the Inspector;
- that an effective on-site and off-site regulatory regime should be initiated; and
- the introduction of an enforceable regulatory code covering the way in which a corporate service provider undertakes its duties.

We are pleased to note that many of these deficiencies have already been identified by the FSD and efforts are being made to rectify them.

1.4.9 **Partnerships**

We are of the view that, with some minor exceptions, the legislation and systems in place in the BVI concerning limited partnerships meet, and in some respects exceed, good practice.

Our principal recommendations are:

- that where the accounting records of a limited partnership are not kept at its registered office, the registered office should maintain a written record of where they are kept; and
- that the Registrar of Companies (who is also responsible for the registration of limited partnerships) should have enforcement powers to:

  (1) apply to the courts for the dissolution of a partnership on public interest grounds or on grounds of fraud or insolvency; and

  (2) apply to the courts for the appointment of an inspector to investigate the activities of a limited partnership.

1.4.10 **Trusts**

Trust legislation in the BVI is similar to the trust legislation in a number of other jurisdictions. In general, we do not consider that there are any features of the Trustee Act that are likely to lead to trust structures in the BVI being considered particularly attractive to those wishing to engage in criminal conduct.

As a general point, rather than one specific to the BVI, we recommend that legislation is amended to prevent the use of so-called "flee" clauses in trust documents to frustrate legitimate creditors or to prevent regulatory or criminal investigation.

1.4.11 **Trust service providers**

Unlike a number of jurisdictions, both on and off-shore, the BVI regulates the provision of trust services and, therefore, are already addressing many of the good practices detailed above.

BVI also recognises that its current regulatory supervisory regime does need enhancement to meet fully the good practice requirements. The principal areas for improvement are:

- the current exclusion of those who undertake trust service provision as an individual or partnership should be ended;
- the extent of activities that may be undertaken by a restricted trust licence holder should be reduced;
- the on-site and off-site inspection process should be improved;
- there should be an enforceable code of practice for licence holders; and
- there should be an enhancement of the regulator's supervisory powers.

1.4.12 **International co-operation**

The BVI Government has been progressive in enacting legislation that will assist the regulators in the BVI to co-operate with foreign regulatory authorities. The legislation in place in the BVI concerning confidentiality and international co-operation substantially meets the international and good practice standards. There are, however, a number of issues that the BVI must address to ensure full compliance with these standards.

The BVI has not yet introduced legislation to enable assistance to be provided to foreign regulators in investigations they are undertaking. However, an Information Assistance (Financial Services) Bill, which is intended to provide this assistance, has been drafted.

We consider that there are insufficient gateways in the Mutual Funds Act through which the Registrar of Mutual Funds can pass information to foreign regulatory authorities. We note, however, that the BVI Government has recently formally announced that gateway provisions equivalent to those in the other pieces of regulatory legislation will be inserted into this Act.

We regard these responses to the current weaknesses in international co-operation as positive.

Our other principal recommendations include legislative changes to the Criminal Justice International Co-operation Act to bring it fully in line with international standards and an enhancement in the transparency of the BVI's international co-operation.

1.4.13 **Anti-money laundering**

The BVI has introduced a number of legislative provisions designed to bring the Islands into compliance with international standards, including modern "all crimes" anti-money laundering legislation. The legislation taken as a whole is reasonably extensive and contains much of the material and covers most of the issues that we would expect to find in the legislation of a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of the BVI's commitment to prevent money laundering.

There is however a need to complete the process. The enactment of the Drug Trafficking Offences (Amendment) Bill and the bringing into force of the Code of Practice will go a considerable way towards achieving this.

Additionally, the recommendations contained in the other sections of this Report relating to changes in the regulatory structure and international co-operation must be implemented, particularly those concerning regulatory on-site visits, which should cover compliance with the Code of Practice.

1.5 **Conclusion**

The BVI has made demonstrable efforts to bring its financial regulatory system into line with international standards. In particular, its recent efforts in respect of mutual funds are creditable.

The BVI nevertheless recognises that the nature of its financial service sector, particularly with its very large numbers of IBCs, means that the jurisdiction is a potential target for criminal abuse such as the use of corporate vehicles for money-laundering or fraud. A number of steps are, therefore, still needed. In particular there is a need to implement the Anti-Money Laundering Code of Practice and to introduce legislation for securities/investment business, improved international co-operation and enhanced powers to deal with money laundering. Many of these legislative developments are already in progress and it is important that this progress continues without delay.

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Prepared 27 October 2000

2 Methodology

2.1 Introduction

2.1.1 The UK Government White Paper

The UK Government White Paper "Partnership for Progress and Prosperity: Britain and the Overseas Territories" ("the White Paper")[1] was presented to the UK Parliament in March 1999.

The White Paper recognised that the international financial service industry has grown dramatically in recent decades and that a significant number of the Overseas Territories have developed successful offshore financial sectors and so diversified their economies. The White Paper further commented that it was essential for the future of the financial services sector that the Overseas Territories reputation for honest administration and probity be preserved and enhanced.

The White Paper stated that development of sizeable financial sectors brings risk of abuse and that as markets develop and techniques for laundering money, fraud, tax evasion and regulatory abuse evolve so financial regulatory systems must improve, be updated and be responsive to ever tighter international standards.

The White Paper further stated that the Caribbean Overseas Territories in particular are a potential target for money launderers because of their offshore financial business, their proximity to major drug producing and consuming countries and, in some cases, their inadequate standard of regulation and strict confidentiality rules. The White Paper also stated that the Territories are also at risk from attempted fraud and that failure to tighten regulation could affect the stability of and confidence in financial markets. The White Paper emphasised the importance of the Overseas Territories meeting accepted international standards. To assess progress made in this area, it required an in-depth independent review to be undertaken by regulatory experts. This review was also to make recommendations as to how to deal with any issues outstanding.

2.1.2 Development of the review process

Following the publication of the White Paper, a Steering Committee was formed. This Committee comprised representatives of the Foreign and Commonwealth Office ("FCO"), the Treasury, the Financial Services Authority and the Governments of the Overseas Territories.

The Steering Committee approved the Terms of Reference ("TOR") for this review, together with Guidance Notes on international standards and good practice relating to the areas under review. We understand that the guidance on accepted international standards in financial regulation ("the Guidance Notes") contained within the TOR was arrived at following a process of detailed consultation and discussion between representatives of the Overseas Territories, the FCO, HM Treasury and the UK Financial Services Authority. These are attached in Appendix 1.

The Guidance Notes represent good practice. The Overseas Territories have therefore chosen to be assessed against standards which, in a number of areas (such as company and trust service provision), are not applied in a number of major centres. This approach demonstrates the commitment of the Overseas Territories in seeking to ensure that financial regulation in these jurisdictions will eventually meet high standards. As such they are providing a powerful role model to other offshore centres.

The Guidance Notes do not prescribe how particular standards should be achieved; rather, the Overseas Territories are left to decide for themselves how best to achieve the standards laid down in them.

On 20 December 1999 we were appointed by the FCO, acting on behalf of the Steering Committee, to undertake the review of financial regulation referred to above.

The review covers Anguilla, Bermuda, the British Virgin Islands ("BVI"), the Cayman Islands, Montserrat and the Turks & Caicos Islands ("TCI") (referred to collectively as the Overseas Territories). The White Paper covers a wider number of locations (such as Gibraltar) but this review is restricted to these six Overseas Territories.

The purpose of the review has been to assess the Overseas Territories' performance against international standards and good practice, and to make recommendations for improvement where any territory falls below those standards.

2.2 **Scope of the review**

The scope of the review was as follows:

In relation to the regulation of financial services activity

- List separately the type and composition of offshore financial services business in each Overseas Territory.
- Ascertain what legislation, regulations, rules, guidance, systems and procedures (statutory or otherwise) govern the regulation and supervision of the:

  - Banking sector

  - Insurance sector

  - Securities sector (including mutual funds and stock exchanges).

- Assess the monitoring, supervision and regulation of activity as well as the enforcement of rules, regulations and laws.
- Evaluate to what extent arrangements in the Overseas Territories meet the standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).
- Consider the adequacy of the system of supervision relative to the objectives of Overseas Territories' financial services regulation.
- Comment on the existence and adequacy of depositor and investor protection schemes.
- Determine whether further action is required by any territory in order to meet the standards set out in the Guidance Notes and prioritise recommendations.

In relation to the regulation of companies, partnerships and trusts

- Ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts.
- Detail the type of information available on the activities of companies, partnerships and trusts.
- Determine whether the regulatory mechanisms in place are sufficient to meet international standards.
- Consider whether further action is required by any Overseas Territory to meet the standards required and prioritise recommendations.

In respect of independent regulatory authorities

- Evaluate to what extent regulatory authorities comply with accepted international standards advocated principally by Basel, IOSCO, the Offshore Group of Banking Supervisors (OGBS) and IAIS.
- In particular, evaluate whether regulatory authorities are accountable, independent and free from business and political influence and properly staffed and budgeted for with an independent source of income.
- Determine whether the relevant authority is detached from the marketing of financial services and, where this is not so, assess any impact this may have on the ability of the regulatory authority to regulate the sector objectively.
- Assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; co-operate with requests for assistance from foreign authorities; enforce rules, regulations and laws by taking enforcement action; and the extent to which they can liaise with law enforcement authorities in the sharing of information.
- Consider which activities fall under the responsibility of the regulatory authority and whether the regulatory net

covers all financial activities.

- Consider what legal advice is available to the authority and its effectiveness in helping the Overseas Territory's government to regulate the sectors.

In relation to international co-operation

- Evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of the Overseas Territory's law enforcement and regulatory authorities to co-operate with requests for assistance from foreign authorities.
- Ascertain what legal advice is available to regulatory and law enforcement authorities in the Overseas Territory, and determine effectiveness in helping the Overseas Territory's government to co-operate in these areas.
- Determine whether further action is required by any territory in any of these areas, and the relative priority of such action.
- Consider whether there are effective "gateways" provisions in place concerning co-operation between regulatory authorities as well as the Overseas Territory's powers to obtain information, including by compulsion, the ability of foreign authorities to take voluntary testimony from the Overseas Territory's residents and the Overseas Territory's ability to safeguard the confidentiality of information provided by foreign counterparts. In addition, determine whether there are any provisions governing conditions under which information may be passed to overseas jurisdictions and whether effective memoranda of understanding exist (where required to underpin co-operation).
- Assess the extent to which the Overseas Territory's law enforcement authorities can obtain evidence on behalf of their foreign counterparts and exercise other available mutual legal assistance powers, stating the mechanisms and the Overseas Territory's authorities involved.
- Assess the Overseas Territory's ability to assist foreign authorities in tracing, freezing and confiscating proceeds even if the underlying conduct takes place outside the Overseas Territory.
- Assess the effectiveness of mutual legal assistance treaties with the USA where applicable and provide the basic volume of requests for assistance made and received.
- Assess powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted.
- Assess the ability to safeguard the confidentiality of information provided to Overseas Territory's law enforcement authorities.
- Assess whether effective memoranda of understanding exist, where required, to underpin co-operation.
- Evaluate whether there is effective co-operation between law enforcement authorities and financial regulators both domestically and abroad.
- Consider the ability of the Overseas Territories' regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

In relation to measures to combat money laundering

- Establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the Overseas Territories to combat money laundering and types of offences caught by the legislation.
- Determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.
- Evaluate the effectiveness and adequacy of those arrangements in terms of how they meet the applicable international standards.
- Provide specific consideration to the offences considered predicate for the purposes of money laundering legislation.

- Consider whether the Overseas Territories' have regulatory legislation in addition to the principal money laundering offences and, if not, whether guidelines and/or codes of practice exist (statutory or otherwise).
- Consider the Overseas Territories' systems for reporting suspicious transactions and identifying customers, the institutions obliged to report, how reports are dealt with and within what timeframe.
- Consider how this information is disseminated and shared with foreign counterparts.
- Evaluate the ability of financial intelligence units or their equivalent to deal with suspicious transactions.
- Determine to what extent the Attorney-General's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws.

2.3 **Project governance**

2.3.1 **The Steering Committee**

The Steering Committee played a key role in setting the parameters for and guiding the conduct of the review by its involvement in:

- agreeing the TOR and benchmark standards to be applied by the review team prior to its appointment;
- offering guidance over the detailed review process through a series of Steering Committee meetings which took place at key stages in the review process; and
- agreeing the format and reviewing the content of this report and providing comment as appropriate.

The responsibility for the opinions expressed, is however, a matter for KPMG.

2.3.2 **The Strategic Team**

In undertaking the review, KPMG utilised a Strategic Team composed of former senior regulators from a number of different jurisdictions, as well as its own partners and staff. The involvement of these individuals enabled the assessment better to take into account how the standards are implemented in practice on an international basis.

Members of the Strategic Team have had significant involvement in the setting of international standards as well as their implementation. The team included a former Chairman of IOSCO's Technical Committee, the Director of Regulation at Lloyd's of London, a former Deputy Director of the United States Securities and Exchange Commission of International Affairs, a former executive Director of the Hong Kong Securities and Futures Commission and the former Chief Executive of the Isle of Man Financial Supervision Commission.

The external members of the Strategic Team provided advice and guidance to KPMG, particularly during the early stages of the project and through the initial drafting of this report. The role of the external members of the Strategic Team was advisory, however, and the analysis and recommendations in this report are the responsibility of KPMG.

2.3.3 **Responsibility for this report**

This report has been prepared by the UK firm of KPMG. Although we have associated firms in the Overseas Territories, they have not been involved in the preparation of this report, nor should any responsibility for any of the opinions in this report be attributed to them.

2.4 **Approach to the review**

2.4.1 **Structure of the report**

The individual sections of the report are generally divided into a number of parts, as follows:

- an introduction, giving a broad outline of the international standards and/or good practice against which our assessment is made;
- a description of the nature and scale of the activity in the jurisdiction;

- a factual assessment produced in conjunction with the Overseas Territory which has been formally confirmed by them as accurate; and
- a section covering the issues arising from our analysis, together with recommendations we consider appropriate to remedy any deficiencies identified.

2.4.2 **Benchmarks**

In determining the appropriate international standards and good practice we have, as instructed in the TOR, used the Guidance Notes.

In the areas of banking, insurance, securities/investments and stock exchanges there are established international standards by which compliance can be assessed. Similarly, with respect to anti-money laundering measures, the recommendations of the Financial Action Task Force and the Caribbean Financial Action Task Force provide benchmarks.

However, in other areas, such as the provision of company and trust services, there are no internationally accepted standards. The Guidance Notes have instead been based upon what has been agreed as good practice.

In accordance with the TOR we have, in conducting this review, taken due notice of the recommendations made in the recent Home Office report on the Review of Financial Regulations in the Crown Dependencies. However, the terms of reference for the two reviews are substantially different in that benchmark standards were not defined in the Home Office review and hence there was no requirement to make an assessment against them.

Accordingly, in framing our recommendations we have assessed compliance with the benchmark standards set out in the TOR.

2.4.3 **Phases of the review**

2.4.3.1 ***Legislative review***

At the outset of the review the Overseas Territories provided us with copies of relevant legislation and regulations.

2.4.3.2 ***Pre-visit questionnaires***

Prior to commencing our on-site reviews, we prepared a pre-visit questionnaire for completion by each of the Overseas Territories. The questionnaire covered the areas required by the TOR. A draft questionnaire was reviewed by the Steering Committee and their comments were incorporated prior to issue. Comments were also invited and received from other parties with experience in relevant areas, for example the FATF in respect of money laundering.

Following this consultation the questionnaire was issued and responses received from the Overseas Territories. These responses were analysed by us prior to the commencement of the on-site review.

2.4.3.3 ***On-site review programme***

The analysis of questionnaire responses was used to prepare a work programme for the on-site review. This mechanism was important in ensuring that the on-site stage of the work was completed to a consistent standard across all the Overseas Territories.

2.4.3.4 ***On-site review***

The on-site review was undertaken in March and April 2000. It comprised in excess of twenty-six man weeks in the Overseas Territories. A total of eight staff, together with two members of the Strategic Team, were deployed across the Overseas Territories. Each consultant was allocated a specific area for review in line with their sector specialism. Work was conducted in line with the on-site review programmes outlined above, adjusted where necessary for issues identified on-site.

2.4.3.5 ***Meetings with third parties***

As part of the review process we had extensive discussions and meetings with third parties (in the UK, the Overseas Territories and elsewhere) who had experience of, or an interest in, the jurisdictions under review. These third party discussions were particularly pertinent in the areas of international co-operation and anti-money laundering measures.

Meetings with the third parties referred to above included:

- The United States Securities and Exchange Commission ("SEC");
- The United States Department of Justice ("DoJ");
- Representatives of the Overseas Territories;
- The United States Federal Reserve;
- The White Collar Criminal Investigation Team ("WCCIT");
- The Overseas Territories Regional Criminal Intelligence System ("OTRCIS");
- The Financial Services Authority ("FSA");
- The National Criminal Intelligence Service ("NCIS"); and
- The Ontario Securities Commission ("OSC").

2.4.3.6 ***Findings from previous reviews***

Our review also considered the results of previous reviews of sectors of the various Overseas Territories. These included:

- the 1992/3 Bank of England "Report on the arrangements for the supervision of offshore banks", covering Anguilla, the BVI, Montserrat and the TCI;
- the CFATF mutual evaluation of Bermuda, the BVI, the Cayman Islands and the TCI; and
- the 1993 Sullivan Reports on the regulation of insurance in Anguilla, the BVI, the Cayman Islands, Montserrat and the TCI.

In addition to the above, we have used other information sources including promotional and advisory material issued by the Overseas Territories and others.

2.4.3.7 ***Reporting***

Whilst we have sought to give due credit for regulatory achievement wherever possible, it should be noted that our reports are phrased on an exceptions basis. We have identified issues and made recommendations in those areas where we consider they are required. The nature of our issues and recommendations tend to reflect the stage of regulatory development reached by the jurisdiction in question.

Those jurisdictions with more mature financial sectors and better developed regulation have tended to generate more detailed recommendations.

In those jurisdictions where we have identified a more significant lack of basic regulatory structures, our recommendations are, necessarily, focused on the major issues to be addressed. There will inevitably be many subsidiary issues which will need to be considered following action on those which are more fundamental. It is impossible to anticipate these until those more significant issues have been addressed.

2.4.3.8 ***Confirmation of factual accuracy and discussion of findings***

Following the on-site reviews, we issued initial draft reports in May 2000. We then visited each of the Overseas Territories over a two-week period at the end of May.

This second visit was designed to give the Overseas Territories the opportunity to comment on findings and confirm the factual accuracy of the initial draft reports. Comments received during the course of this visit were confirmed (where they related to issues of factual accuracy) and considered. Our draft reports were adjusted where the review team considered this to be appropriate.

Following these second on-site visits, further draft reports were prepared. These were issued on 17 July. They were also discussed with the Overseas Territories who (along with the Steering Committee) were again given an opportunity to comment. Written as well as oral comments were received from the Overseas Territories and others; all have been carefully considered.

The Overseas Territories have provided formal written confirmation of the factual accuracy of the relevant parts of our reports.

2.4.4 **Regulatory arbitrage**

Regulatory arbitrage is the selection of a jurisdiction of operation on the basis of the regulatory legislation and structure in place. Regulatory arbitrage tends to result in persons who, for their own reasons, wish to avoid regulation selecting less regulated jurisdictions. Consequently less regulated jurisdictions often become a target for money launderers and fraudsters.

All the jurisdictions have expressed a commitment to achieve the required international standards in financial services regulation envisaged by the White Paper. We consider that it should be recognised that other offshore centres, not being part of the Caribbean Overseas Territories and Bermuda, who also provide financial services and who may be regarded as competitors of the Overseas Territories, may not share the same level of commitment.

To prevent the possibility of regulatory arbitrage, even on a short-term basis, the adoption of international standards should be seen as a global issue and not simply one of relevance to the Overseas Territories. Therefore, other jurisdictions should be encouraged to ensure that they introduce similar improvements and thereby facilitate a level playing field between jurisdictions.

The work of groups such as the Financial Stability Forum in raising global standards will be of importance in this area and should continue to receive strong support from both the UK and the Overseas Territories.

2.4.5 **Scope limitations and other related matters**

Our terms of reference do not provide for us to verify all the factual matters in this report, which would be a major and time consuming task. Instead, as agreed with the Steering Committee and set out in the TOR, we asked the Overseas Territories to provide us with information (including copies of relevant legislation) and to check various drafts of our reports for factual accuracy. This they have done. It should be appreciated that any further information not provided to us might alter our conclusions.

In a number of instances, sector information (for example total funds under management and analyses of a jurisdiction's main sources of business) is not collated by the jurisdiction and therefore was not available to us. In other cases available information is dated.

There was also, on occasion, a lack of available statistical information, particularly in relation to co-operation provided by the Overseas Territories to other jurisdictions. It appears that either this information is not available in a format that is retrievable to provide the statistics necessary, or it is not kept at all. The absence of such information has made certain comments on the level of co-operation provided by the Overseas Territories impossible to verify or refute. Recommendations to resolve this matter have been made in the report.

This report has been prepared for the sole purposes of a review of Financial Regulation in the Caribbean Overseas Territories and Bermuda for the Steering Committee comprising representations from the Foreign and Commonwealth Office, HM Treasury, Financial Services Authority and Governments of Bermuda, Cayman Islands and Anguilla ("the client"). It has been designed to meet the agreed requirement of the client and particular features of the engagement of KPMG determined by the clients needs at the time. This report should not therefore be regarded as suitable to be used or relied on by any person or organisation other than the client or for any other purpose or in any other context. Any person or organisation other than the client who chooses to rely on this report will do so at its own risk. KPMG will accept no responsibility or liability in respect of this report to any third party.

2.4.6 **Timescales**

Whilst we have noted areas where we consider action is required as a priority we have not set out specific timescales. We consider that the precise timescales are best determined bilaterally between the individual overseas territories and the Foreign and Commonwealth Office.

2.4.7 **Acknowledgements**

We are most grateful for the significant amount of time spent by representatives of the Overseas Territories, Her Majesty's Government and the other organisations whom we met.

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Prepared 27 October 2000

3 Regulatory authority

3.1 Introduction

As stated in the White Paper, a sound, transparent regulatory environment is necessary to maintain investor confidence and the reputation of the financial sector in a particular jurisdiction. This is only possible if the regulatory authority is, and is seen to be, independent.

In order to demonstrate this 'independence', the jurisdiction must be seen to meet international standards. These standards extend beyond simple independence to encompass such issues as resourcing and accountability. This theme is developed further below.

Our terms of reference cite four documents which provide specific details on what the international community expects from a regulatory authority. These documents are:

- Objectives and Principles of Securities Regulation issued by the International Organisation of Securities Commissions ("IOSCO");
- Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision ("Basel");
- The Supervision of Cross-Border Banking by Basel and the Offshore Group of Banking Supervisors ("OGBS"); and
- Insurance Principles, Standards and Guidance Papers by the International Association of Insurance Supervisors ("IAIS").

These documents consider all aspects regarding the regulatory authority including licensing, supervisory and enforcement powers and the ability of the authority to co-operate with other regulatory and legal bodies.

In addition, the Guidance Notes introduce several concepts which are not explicitly referred to in the documents above but which are included in the scope of our review.

International co-operation and the powers of the regulator pertaining to the different financial sectors in the jurisdiction are dealt with elsewhere in this report.

This section deals solely with the consideration of the remaining principles relating to the regulator. The Supervision of Cross-Border Banking and the Insurance Principles, Standards and Guidance papers do not refer to this subject and, as such, their content has been excluded from this discussion.

3.1.1 Principles relating to the regulator

The following section sets out the criteria underpinning what constitutes a regulatory authority which is deemed to meet acceptable international standards and the implications for the jurisdictions under review.

The source of the information set out in this section is Basel principle 1, IOSCO principles 1 to 5 and the Guidance Notes.

The regulatory authority should have clearly defined responsibilities, be operationally independent and accountable, have adequate powers and resources, be consistent in its approach and observe the highest professional standards including upholding appropriate standards of confidentiality.

- Clear responsibilities

Ideally the responsibilities of the regulator should be set out in law and adequate legal protection should be provided to the regulatory authority and its staff. Legislation should be designed to avoid gaps or inequities in regulation.

- Independence and accountability

The regulator should be operationally independent from external political and commercial influence and be accountable in the use of its powers and resources. Independence is deemed to be enhanced by a stable source of funding and would be considered to be compromised by any marketing activities carried out. Approval of decisions made by the regulator by the government or a minister does not necessarily constitute a lack of demonstrable independence providing any such consultation does not include decision making on regulatory matters.

- Powers and resources

The regulator must have adequate powers and the capacity to exercise its powers, including licensing, supervision, inspection, investigation and enforcement. In many cases these powers vary across the financial sectors represented in the jurisdiction and therefore these are considered in the relevant sections of this report.

In order to exercise its tasks, the regulator must be adequately funded with the level of funding reflecting the difficulty of retaining experienced staff. Training should be provided as required on an ongoing basis.

- Clear and consistent processes

The processes adopted by the regulator should be comprehensible, transparent, fair and equitable and consistently applied. On policy decisions, the regulator is expected to consult with those who may be affected; it is generally desirable to make public disclosure of policy. The regulatory authority should also play an active role in the education of financial service industry participants.

- Staff conduct

Staff of the regulator are expected to observe the highest professional standards and be given clear guidance on conduct matters including on conflicts of interest, use of information obtained, fairness and the observance of confidentiality provisions.

3.2 Factual assessment

3.2.1 Clear responsibilities

3.2.1.1 *Constitutional position*

The responsibility for the regulation and supervision of financial activities in the BVI is vested in the Governor in Council and in the Minister of Finance.

Depending on the nature of the activity either, the Governor in Council, or the Minster of Finance is responsible for all licensing, revocation of licences and enforcement decisions relating to regulated firms. In the case of mutual funds, the Governor in Council is responsible for licensing public funds and the Minister of Finance for recognising non-public funds and for licensing fund managers and administrators.

3.2.1.2 *Regulatory structure*

The day-to-day regulation of offshore financial business is undertaken by the FSD which includes the company registry.

The FSD is staffed with a Director, Deputy Director and 57 other employees, the majority of whom are involved with the registry section. Of those assigned directly to the regulation of financial institutions, four are assigned to banks, trust companies and company managers, four to the insurance sector and five to mutual funds. The heads of these departments are the Inspector, the Commissioner and the Registrar respectively.

The Director reports directly to the Minister of Finance. There is no formal statement as to the role of the regulator; regulatory responsibilities are contained in the various pieces of financial service legislation in force.

3.2.1.3 *Gaps in regulatory coverage*

Currently the BVI does not regulate securities/investment business with the exception of the managers and administrators of collective investment schemes. Details of this are contained in Section 6 of this report.

3.2.1.4 *Immunity for regulators*

Section 9 of the Insurance Act provides that no liability will be incurred by, and no suit, action or proceeding can take place

against the Crown or Commissioner of Insurance, or any person acting under their authority, for any action or omission done in the bona fide carrying out of their duties. A similar provision is included under Section 37(1) of the Mutual Funds Act.

Under Section 27 of the Banks and Trust Companies Act, no liability attaches to the Governor in Council or the Inspector of Banks and Trust Companies, or any person acting under their authority, for an act done in good faith in the discharge or purported discharge of his functions. The same provision is made under Section 25 of the Company Management Act.

3.2.2 Independence and accountability

3.2.2.1 *Accountability*

The FSD is a government department responsible to the Minister of Finance and through him to the Executive and Legislative Councils. Only the Registrar of Mutual Funds has a statutory function to produce an annual report which is available to the public. All other reports generated by the regulator are internal.

3.2.2.2 *Marketing responsibilities*

The FSD's involvement in the marketing of the BVI as a financial centre is limited to the extent that it relates to media and promotional programmes which are confined to factual press releases, articles, supplements and presentations aimed at disseminating accurate information on regulatory norms, procedures and practices. Nevertheless such activity can involve considerable regulatory time.

As an example the insurance staff will accompany the BVI insurance managers and brokers to annual RIMS (Risk & Insurance Management Services) meetings in an effort to sell the virtues of the BVI's regulatory approach.

3.2.3 Powers and resources

3.2.3.1 *Introduction*

Those parts of the Guidance Notes which relate to powers and resources pertaining to international co-operation and the powers of the regulator in respect of the different financial sectors in the jurisdiction are dealt with in the sector specific sections of this report.

3.2.3.2 *Staffing*

Of the 57 people employed by the FSD, 13 are directly responsible for financial services regulation.

3.2.3.3 *Licensing power*

Whilst some licensing powers have been delegated to the Registrar of Mutual Funds, the FSD does not have any licensing powers in its own right. Licensing decisions are made by the Governor in Council and the Minister of Finance in the case of mutual fund managers and administrators.

3.2.3.4 *Budgeting*

The budgeting process is undertaken by the Director who submits a draft budget to the Financial Secretary. The draft budget is discussed and agreed, along with all other departmental budgets, by the Executive Council (Governor in Council).

3.2.3.5 *Sources of income*

All income is provided from the BVI Government budget. All income generated from fees is remitted directly to the Government.

3.2.3.6 *Legal support*

Legal support is provided to the FSD by the Attorney-General's Chambers.

3.2.4 Clear and consistent processes

3.2.4.1 *Involvement in legislative development*

The FSD has a significant involvement in legislative development and either leads the development process or, at least, plays a leading consultative role.

3.2.4.2 ***Documented procedures***

There is not a fully documented internal procedures manual covering key areas such as licensing procedures, off-site supervision, on-site supervision and enforcement. In addition there are no procedures relating to training and competence.

3.2.4.3 ***Disaster recovery plan***

There is no formal disaster recovery plan in place.

3.3 Issues and recommendations

3.3.1 Overview

Although we consider the FSD to be a well-run regulator with a strong commitment to achieving international standards, we do not consider the current regulatory structure to be fully in accordance with International Standards. This is because the current position by which the Governor in Council is responsible for licensing and enforcement action relating to financial service activity means the regulator is not operationally independent. In addition we consider that three matters need to be addressed, which are in relation to staffing, marketing and disaster recovery. Details of these are set out below.

3.3.2 Regulatory independence

In our view operational independence means the ability of the regulatory authority to act in the best interests of regulation (systemic, national and protection of customers), free from political and private sector interference, (so avoiding the danger of regulatory capture), but with proper political accountability.

Whilst we saw no evidence of political interference in the day-to-day operation of the FSD, the legal framework is such that there is the possibility of such interference at some point in the future.

We, therefore, consider that, in order to meet these international standards the FSD should become an operationally independent body and be responsible for licensing and enforcement decisions.

In line with international standards such a body should have its own funding source. This could be achieved by the regulator being the initial recipient of licence fees, passing on surplus to the government. In order to ensure efficiency the regulator would be required to prepare budget forecasts and justify any variances by means of an annual report.

A supervisory board for the new regulator could be established, part of whose function would be the monitoring of efficiency. The structure of membership of this board should be carefully constituted to ensure that there is not undue influence from either the public or private sector. Consideration should be given to including appropriate expertise from outside the islands to provide additional breadth in skills.

The regulator, once established would take on direct responsibility, amongst other things, for licensing, supervision and enforcement. The powers currently vested with the individual officeholders under the various pieces of financial service legislation would be transferred to the new regulator.

The regulator will need to be accountable to Government. We believe it should also produce an annual report of its activities and that this should be a public document.

Furthermore, in the context of the matters referred to above, the FSD should be subject to a formal review with a strategic plan for its development produced following this exercise.

As an interim measure the powers of the Governor and Minister under the various pieces of legislation should be delegated to the appropriate regulator.

3.3.3 Staffing

Whilst the current staff includes officers with considerable experience, the existing number will not in our view be sufficient to meet the increased workload resulting from recent and proposed regulatory developments. We consider that this will be particularly acute in relation to mutual funds and, in relation to on-site supervision in general, will mean that increased staffing is a necessity.

The process for recruiting additional staff should commence as soon as possible.

As an independent body the regulator would be in a position to recruit new staff and remunerate existing staff on a level equivalent to that of the private sector. Irrespective of any decision regarding an independent body, efforts must be made to ensure that remuneration of regulatory staff be made comparable with the private sector in order to assist with the recruitment and retention of staff.

3.3.4 **Marketing**

The role of marketing the BVI as a jurisdiction is inconsistent with the international standards expected of an independent regulatory body. We would recommend that responsibility for marketing activities is retained by the Government with the independent regulatory body retaining an educational and informational role. The regulatory body would also act as a source of quality control in advertising by confirming the factual accuracy of adverts and promotions.

3.3.5 **Disaster recovery plan**

We consider that a formal plan be developed to ensure the security of records and other documentation.

We welcome your comments on this site.

Prepared 27 October 2000

4 Banking

4.1 Introduction

There are established international standards in place concerning the regulation and supervision of banking. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of banking conform to the standards outlined in the "Core Principles for Effective Banking Supervision" (the "Core Principles") produced by the Basel Committee on Banking Supervision ("Basel Committee"), together with the report by members of the Basel Committee and members of the Offshore Group of Banking Supervisors on the "Supervision of Cross-Border Banking".

The Core Principles comprise 25 basic principles required to be in place for a supervisory system to be effective. The Principles cover:

- preconditions for effective banking supervision (Principle 1);
- licensing and structure (Principles 2 to 5);
- prudential regulations and requirements (Principles 6 to 15);
- methods of ongoing banking supervision (Principles 16 to 20);
- information requirements (Principle 21);
- formal powers of supervisors (Principle 22); and
- cross-border banking (Principles 23 to 25).

The requirements relating to cross-border banking were developed by the report "Supervision of Cross-Border Banking". This detailed the requirements for effective home and host banking supervision in order to facilitate effective consolidated supervision including the associated necessary information flows between regulators.

Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against the above standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.`

4.2 Type and scale of activity

The BVI does not actively encourage applications for banking licences. This is reflected in the scale of the sector. As of December 1999 there were 13 authorised banking institutions in the BVI with fixed assets of US$2.7 billion, tier one capital of US$103 million and total capital of US$153 million.

Banks are granted either a general banking licence or a licence that restricts them to activity in the offshore sector. General licence banks offer a full complement of commercial banking services within and outside the jurisdiction. Restricted licence banks offer private banking services to residents outside of the BVI.

There are currently six general licence banks and seven restricted licence banks.

All the BVI's licensed banks are subsidiaries and branches of international banking groups; and the BVI therefore acts as the "host" regulator. There are no banks for whom the BVI currently undertakes consolidated supervision.

In addition to the above the Development Bank of the Virgin Islands (DBVI) operates as an unregulated deposit taking institution. The DBVI was created with a special mandate to lend money to or invest in industries that promote the development of the BVI. Many of its loans or investments have been made to/invested in the tourism or fishing sectors. The DBVI operates under its own statutory instrument and is not subject to banking regulation. The recent CFATF mutual

evaluation team stated that while the DBVI is subject to the anti-money laundering legislation, the fact that it is not subject to the prudential supervision of the Banking Supervisor was of concern.

4.3 **Factual assessment**

4.3.1 **Legislation**

The legislation covering banking in the British Virgin Islands comprises the Banks and Trust Companies Act 1990 ("BTCA") and Banks and Trust Companies (Amendment) Act 1995.

The BTCA provides that no person or company shall carry on banking business from within the BVI, whether or not such business is carried on within or outside the jurisdiction, unless the person or company has obtained a licence pursuant to the BTCA.

The principal categories of licence that can be issued under the BTCA are:

- a general banking licence which allows the licence holder to carry on banking business within and outside the BVI. The minimum paid up capital for this is US $2 million and the licence holder must deposit the sum of US $500,000 in such a manner as the Governor may prescribe;
- a Class I banking licence which generally prohibits a licensee from conducting business in the BVI. Minimum paid up capital of US $1 million is required and the licence holder must deposit the sum of US$500,000 in such a manner as the Governor may prescribe; and
- a Class II licence restricts a bank to receiving and soliciting funds from persons listed in an undertaking accompanying the application for the licence. Minimum paid up capital of US $1 million is required and the licence holder must deposit the sum of US $500,000 in such a manner as the Governor may prescribe.

The fourth category is related to the undertaking of general or restricted trust business and is covered in a later section of this report.

4.3.2 **Regulations**

4.3.2.1 ***Introduction***

Under section 28 of the BTCA, the Governor may make regulations. By virtue of section 29 of the BTCA the Inspector may make directions in relation to such matters as he may think fit. Failure to comply with a direction is taken into consideration in considering whether any of the Governor's enforcement powers should be taken.

4.3.2.2 ***Regulations made by the Governor***

Under the power vested by Section 28 of the BTCA the Governor has made the following regulations/orders:

Banks & Trust Companies Regulation 1991

This contains the requirements imposed relating to applications for licensing and includes the application forms that must be completed and submitted.

Banks & Trust Companies Regulation (No 2) 1991

This contains the required contents of an affidavit to be given in support of an application by a person to use a word restricted by the BTCA (e.g. trust).

Banks & Trust Companies (Amendment of Fees) Order, 1996

This deals with licensing fees and increased the fee levels from those prescribed in the Second Schedule of the BTCA.

4.3.3 **Directions made by the Inspector**

Under the power vested by Section 29 of the BTCA the Inspector has made the following directions:

Banks & Trust Companies (Application Procedures) Directions 1991

This contains instructions for the completion of application forms.

Banks & Trust Companies (Deposit/Investments) Directions made 1 May 1992

This prescribes acceptable types of deposits or instruments to meet capital requirements.

4.3.4 **Guidance Notes**

Whilst general informal guidance notes have been provided to licence holders, there have been no formal guidance notes developed and issued to the banking industry.

4.3.5 **Supervision - systems and procedures**

4.3.5.1 ***Regulatory structure***

The decision on whether a licence is to be granted is made by the Governor in Council. The BTCA provides for the control of licensees by an Inspector of Banks and Trust Companies (the "Inspector"). The Inspector is a public officer appointed by the Governor.

The Inspector is part of the Financial Services Department ("FSD") and reports to the Director of the FSD.

Support staff for the Inspector currently comprise two assistant banking supervisors who are undertaking a structured training programme.

4.3.5.2 ***Application process***

Licensing decisions are made by the Governor in Council.

Under the BTCA a licence will only be granted by the Governor in Council if he is satisfied that the application is not against the public interest and that the applicant is a person qualified to carry on banking/trust business.

An application may be granted subject to such terms and conditions as the Governor in Council thinks fit.

The BVI has a public policy that a bank will only be considered for licensing if the following criteria are met:

- it is a branch or subsidiary of a bank with a well-established and proven track record and which is subject to effective consolidated supervision by their home supervisory authority; or, in the case of an application for a restricted licence only;
- it is a bank which, although not a subsidiary, is closely associated with an overseas bank, and which, by agreement, will be included within the consolidated supervision exercised by the overseas bank's home supervisory authority; or
- it is a wholly owned subsidiary of an acceptable non-bank corporation whose shares are quoted on a recognised stock exchange where the objective of the subsidiary is to undertake in-house treasury operations only, and where the operations are fully consolidated within the published financial statements of the parent company.

Banks must also demonstrate "mind and management" in the jurisdiction of incorporation unless they are a subsidiary and the "mind and management" is located in the jurisdiction where consolidated supervision is undertaken.

Applicants who meet the guidelines may apply for a licence. The First Schedule of the BTCA sets out the information that should accompany an application for a licence.

The information required includes:

- the names and addresses of all shareholders, directors, officers and managers;
- evidence in writing that the applicant itself or some person directly or indirectly connected with the applicant is possessed of solid and practical experience in banking business or trust business, as the case may be;
- a statement of assets and liabilities at the end of the month prior to the submission of the applicant certified by a director or senior officer.

- a banker's reference and two personal references are required for each of the applicant's directors;
- Due Diligence/Compliance Manual which should include client acceptance procedures and know-your-customer policies;
- 3-year business plan which should include business objectives and financial projections;
- undertaking to establish physical presence in the BVI within a two-year period from the date of issue of the licence; and
- details on the added value the grant of the licence would provide to the economy of the BVI.

The Inspector also uses fit and proper criteria to assess applications.

A full vetting check is in place including vetting non-executive directors and shareholders.

The Inspector reviews business plans at the time of submission. Banks must advise any changes to their business plans.

4.3.5.3 ***Off-site supervision***

Section 15(2) of the BTCA provides that the Inspector shall, *inter alia*, examine by way of regular receipts or in such other manner as he thinks fit, the affairs or business of any licensee for the purpose of satisfying himself that all the provisions of the Act are being complied with, that the licensee is in a sound financial position and that it is carrying on its business in a satisfactory manner.

Quarterly balance sheet ("BS") returns and maturity analysis or liquidity ("MS") returns are reviewed by banking supervisor officers. Subsequent action is undertaken to require banks to correct deficiencies identified.

The Inspector's office performs financial analysis on manual returns for all of its licence holders.

4.3.5.4 ***On-site inspection***

To date, there have been no on-site inspections of banks in the BVI.

In 1999 the Inspector undertook to improve this aspect of the regulatory system via the development of an on-site programme through a consultancy exercise. Training began in December 1999 and a reference manual is now being finalised.

The on-site process is scheduled to begin at the end of 2000.

4.3.5.5 ***Ongoing requirements***

Books and records

All banks are required to maintain proper books and records in accordance with accepted international accounting standards. It is a requirement that all licence holders report to the Inspector on a regular basis, and an auditor must audit the financial statements of the banks on an annual basis. There is no requirement in the BTCA that the auditor be approved by the Inspector.

There is no statutory requirement for restricted licence banks to retain records in the jurisdiction. A number of restricted licence banks have neither books and records nor mind and management in the BVI.

Authorised Agents and Principal Office

All banks are required to have a principal office and two authorised agents, approved by the Governor in Council and Inspector and located in the BVI.

The Governor in Council's approval is required to change either the principal office or authorised agent.

Capital adequacy

There is no Basel capital adequacy reporting format included within the aforementioned quarterly returns. Therefore, it is impossible to determine a risk-based capital ratio. However, a capital adequacy ratio calculation is undertaken by relating

capital to liabilities. The ratio is then compared with the minimum 8% demanded by the Basel group.

The actual ratio computed by the Inspector's officers may understate the true capital position of the banks, as no benefit is extended for having lower risk-weighted balance sheet assets.

Our on-site sample review identified two instances where banks had a capital adequacy ratio of under the prescribed 8%. The Inspector wrote to bank head offices requesting them to recapitalise their subsidiaries in the BVI. As a result one recapitalisation has since occurred.

Liquidity

The MS liquidity analysis form contains eight different time bands to which assets and liabilities are assigned, based upon the timing of their residual maturity. Liquidity is closely monitored.

Large exposures

The BVI is aware of the Large Exposure issue and connected lending information is captured. However, there are no regulations or guidance in relation to this matter.

Derivatives/off balance sheet instruments

Banks engaged in derivatives and other off balance sheet instruments are expected to have appropriate policies and procedures in place. No guidance has, however, been issued to banks regarding the use of derivatives and other off balance sheet instruments.

Anti-money laundering

Licence holders are subject to the anti-money laundering legislation and will be subject to the Code of Practice (when it comes into force), which covers "know your customer" requirements.

Breaches of the anti-money laundering legislation or Code do not currently automatically represent a disciplinary offence by the licence holder. At present, therefore, the Inspector has no automatic power to take action against a licence holder for such a breach. However, the bank may be subject, indirectly to such action as it could be considered to be "carrying on business contrary to the public interest".

4.3.6 **Enforcement - systems and procedures**

Section 20 of the BTCA contains a number of enforcement powers which the Governor in Council can utilise. These include:

- revoking a licence;
- imposing additional conditions on a licence;
- replacing a director or officer;
- obligatory appointment of an adviser or controller;
- appointing a manager/custodian to take over a bank's activities; and
- to take "any action that (he) thinks fit".

Whilst there is no specific power to petition the winding up of a bank in the public interest, this may be possible by using the Governor in Council's general powers to take such action as he thinks fit.

4.3.7 **Depositor protection schemes**

There is no depositor protection scheme in place in the BVI.

4.4 **Issues and recommendations**

4.4.1 **Introduction**

The BVI has a conservative approach to banking. This is evidenced by the BVI's policy of not encouraging banking licence

applications combined with the fact that the BVI does not act as consolidated regulator of any bank. This means that a number of Basel standards are not applicable.

We consider that the BVI is committed to continuing to improve the quality of its banking supervision. However, we concur with the view of the Director of Financial Services that additional work needs to be undertaken to bring the regulation of banking in the jurisdiction fully into line with international standards.

The main issues to be addressed are detailed below.

In addition Basel Core Principle 1 requires operational independence and adequate resources. The BVI is not currently in compliance with this Principle. This is covered in the previous section to this report and, therefore, is not repeated here.

4.4.2 **Minimum capital requirements**

During our review we noted with concern that a licence holder is not currently in compliance with the minimum capital requirements.

We note that this matter is being actioned by the Inspector but recommend that, unless the position is resolved immediately, the necessary enforcement actions are instituted to rectify the matter. If the matter persists the licence should be revoked.

4.4.3 **Access to and sharing of information**

Whilst the Inspector is able to share a significant amount of information with foreign regulators, confidentiality provisions in subsection 15 (4) of the BTCA cause the BVI to fail a number of secrecy tests cited in the Basel Cross-Border Supervision paper. For example, paragraphs 4, 5 and 18 of this paper all refer to the need, for effective regulation to be achieved, for regulators to have access to all information, including client-specific information.

Subsection 15(4) of the BTCA bars the Inspector from access to the name or title of an account of a depositor without a court order. Similarly section 24 (2) restricts the sharing of information with other regulators to "general information about the licensee".

We recommend that these clauses should be amended as a priority to permit access to and disclosure of depositor information, subject to the provision that disclosure is given only on the understanding that the information is being used for legitimate regulatory purposes and will remain confidential.

Such access is also needed to permit effective on-site monitoring, particularly verifying compliance with the know your customer and other requirements for the prevention of money laundering.

In addition, the effective regulation of banks on a consolidated basis relies upon the regular flow of information between regulators in different jurisdictions. As a host jurisdiction the BVI has an important role in this. The Inspector, therefore, should enhance the relationship with other jurisdictions, whether through MOUs or otherwise so enabling the ongoing and immediate sharing of information pertinent to consolidated banking supervision. We understand that this view is accepted and MOUs are being actively considered by BVI.

4.4.4 **Off-site supervision**

In general we consider the off-site supervisory approach to be in need of enhancement.

This is due in part to the limited experience of the Inspector's officers which means that effective analysis is not currently occurring. The Director of the FSD believes the recent appointment of the new Inspector will alleviate this weakness.

There are a number of enhancements which should take place to improve the information currently provided.

These are:

- the Inspector must set requirements to prevent abuses of connected lending (Core principle 10). The Inspector collects such information, is aware of and monitors exposures, however, there are no requirements set in this area;
- at present the BVI licensed banks are not required to produce proper risk management policies and procedures and adhere to them. This should be made a formal requirement. Given the policy of limiting entry to the branches and subsidiaries of major international banks, the BVI banks will have their parents' expertise to draw on in this area; and

- banks should be required to maintain and submit on request, up-to-date business plans. This will enable the Inspector to ensure that he is kept appraised of the current and proposed operations of each bank.

Additionally the Inspector should have a formal prudential meeting at least once a year with each of the banks and their auditors to discuss, *inter alia*, business plans, variance from previous business plans and reasons for the variance. The meetings should be formally structured and documented.

4.4.5 **On-site inspection**

We support the decision by the BVI to commence on-site inspections.

Such a programme should, if undertaken thoroughly, seek to address the following weaknesses in the current regulatory regime and satisfy the stated Basel Principles including;

- carrying out an evaluation of a bank's policies, practices and procedures for loans and investments (Principle 7);
- ensuring that banks have policies, practices and procedures for evaluating the quality of assets and adequacy of loan loss provisions and loan loss reserves (Principle 8);
- being satisfied that management information systems are in place to identify concentrations (Principle 9);
- being satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk, market risk and transfer risk (Principles 11 and 12);
- ensuring that that banks have comprehensive risk management processes in place (including board and senior management oversight) (Principle 13);
- ensuring that banks have comprehensive adequate internal controls (Principle 14);
- ensuring that banks have adequate policies, procedures and practices including "know your customer" (Principle 15); and

Whilst elements of the above areas can be and, in places are, being achieved through off-site supervision, we consider on-site verification is vital for full compliance to be achieved.

We note the proposal to commence on-site inspections by the end of 2000. We recommend that the programme ensures that all licensed banks are inspected during 2001 and that a risk based visit programme introduced with an average cycle of three years.

We further recommend that the on-site visits should include those banks without books and records or "mind and management" in the BVI ("Cubicle Banks" colloquially known as "brass plate banks").

4.4.6 **Ongoing requirements**

We consider that, in respect of capital adequacy the forms and accompanying notes required for completion by licence holders should include the necessary information for a Basel capital adequacy calculation to be made.

In the case of liquidity assessment there is scope for the time bands (for assigning assets and liabilities according to their remaining period to maturity) to be improved in line with international practice. This is because, if liquidity is a problem for a bank, it is likely to be within these shorter duration time bands.

4.4.7 **Consolidated supervision**

The BVI relies upon the ability of foreign regulators to undertake consolidated supervision in a number of cases. It is, therefore, important that it is able to satisfy itself that such supervision is being undertaken effectively.

Whilst non-objection or prior consent for the establishment of a branch or subsidiary is routinely obtained there is no current check of foreign regulators' capability to perform consolidated supervision. There is also a benefit in forming an on-going dialogue with the foreign regulator, preferably through a formal MOU.

We recommend that the FSD should, as a priority, undertake a review of the jurisdictions where it is relying upon foreign jurisdictions exercising consolidated supervision. In doing so, focus should be placed on those jurisdictions which are not

members of the Basel Committee.

4.4.8 **Authorised agents**

We consider the role of the authorised agent is important, particularly when it is the representative of the licence holder with no mind and management in the jurisdiction and is, therefore, the first point of contact for the regulator. It is therefore important that they are competent to undertake this role and are exercising proper diligence in their task.

We consider the FSD should issue a formal code to authorised agents detailing what is expected of them in the undertaking of their duties. In addition we consider that the FSD should undertake reviews of authorised agents to verify compliance with this code.

The code should cover, *inter alia*:

- what information about the bank the agent is expected to have;
- what ongoing due diligence checks and other monitoring the agent should undertake;
- duties of reporting to the FSD; and
- duties relating to any other services provided by the agent (eg directors).

4.4.9 **Anti-money laundering**

Whilst we accept that the breach of the anti-money laundering code could be considered "carrying on business contrary to the public interest", we consider that, to make the position absolutely clear, a breach of any anti-money laundering laws, codes, guidance or regulations should formally be grounds for disciplinary action against a licence holder, including possible revocation of its licence.

4.4.10 **Role of the auditor**

We consider that it would be prudent for a requirement to be introduced under which the Inspector is required to approve the auditor of a bank. Currently no such power exists under the BTCA. This power would enable the Inspector to verify that the auditor had the necessary experience and resources to conduct the audit.

We also recommend that the auditors should provide an opinion on the licensees' systems and controls including record keeping.

Additionally as stated above, there is currently no provision within the BTCA providing a gateway for the auditor to disclose information on a licence holder to the Inspector, nor is there an obligation imposed on the auditor to report certain matters or events to the Inspector.

We consider that a duty of reporting combined with an exemption from the general duty of confidentiality in such reporting would be valuable and, therefore, recommend that it should be included in a revision to the BTCA.

Additionally there should be annual prudential meetings with the auditor and licence holder. This meeting should cover, *inter alia*, developments of the bank's business plan.

4.4.11 **Guidance notes**

The lack of formal guidance notes is not in line with good regulatory practice.

Guidance notes are generally used to disseminate policy and reporting requirements to banks. They lack the legal force of regulations but should carry the same import. If they are not complied with, sanctions are usually necessary.

Areas such as risk management policies and procedures, liquidity management, Basel capital rules, large exposures and derivatives are all topics deserving regulatory attention and merit separate guidance notes.

Risk diversification (for example, by location, by industry, by instrument, by currency, by counterparty, etc) is an additional topic that can usefully be covered in guidance.

4.4.12 **Development Bank of the Virgin Islands**

It is important that the DBVI falls under a formal regulatory regime as soon as possible.

We concur with the view of the CFATF mutual evaluation team that while the DBVI is subject to the anti-money laundering legislation, the fact that it is not subject to the prudential supervision of the Banking Supervisor is of concern. We consider that DBVI's peculiar status could potentially represent a weak point in the BVI's anti-money laundering initiatives. We also consider that depositor protection is best served by bringing the DBVI within the regulatory environment.

We understand that there is impetus for bringing the DBVI under the regulatory purview of the Banking Inspector. There are ongoing discussions about the amount of recapitalisation needed from the government before the Banking Inspector assumes this responsibility. The Banking Inspector, rightly in our view, does not wish to assume regulatory responsibility over a weakly capitalised institution.

4.4.13 **Application process**

The BTCA does not formally require fitness and probity checks to be undertaken in assessing a licence application. The only conditions imposed are that the applicant is qualified to carry on banking business and that the application is not against the public interest. Nevertheless such a review is, in practice, undertaken.

We therefore recommend a revision to the BTCA which places the obligation of being "fit and proper" on a statutory footing and thereby reflect current practices.

We welcome your comments on this site.

Prepared 27 October 2000

5 Insurance

5.1 Introduction

The International Association of Insurance Supervisors ("IAIS") has produced a number of principles and standards set out in a series of papers and approved by its members.

These standards recognise that the regulatory framework for insurance supervision varies from country to country and are not mandatory and do not necessarily reflect current practice in all of the member countries. The principles and standards are intended to represent a target for supervisors to work towards and can be implemented in a flexible manner depending upon the circumstances of each jurisdiction.

The Offshore Group of Insurance Supervisors ("OGIS") has also introduced a set of principles, standards and guidance notes upon which self-assessment is required. Conditions of membership of this group include having legislation in place which enables its regulatory authority to adequately supervise insurance business by having the necessary resources and properly qualified supervisory personnel to enforce the legislation.

Of the territories under review, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of OGIS, with Anguilla having observer status.

The Terms of Reference for this review require us to assess performance against International Standards and Good Practice in the insurance sector.

It is against these standards that we have made our assessments. The areas where it is considered that development may be required are contained in the issues and recommendations section of this report.

5.2 Type and scale of activity

The insurance sector in the BVI is governed by the Insurance Act 1994, supplemented by the Insurance Regulations 1995.

The BVI's prominent insurance sector is in the offshore captive market. The statistics here show:

Captive insurance companies 131

Credit life reinsurance captives 59

Three companies registered in the BVI are licensed to undertake third party business. This type of licence is no longer issued.

Actual statistical information on the insurance market is not available. Total gross premium income is estimated, by the Insurance Commissioner, to be US $200-300 million annually for the entire BVI market.

The onshore insurance sector consists of:

- 18 life insurance companies;
- 2 locally incorporated general insurance companies; and
- 10 general insurance companies incorporated outside the BVI.

There are 13 insurance agents operating in the local market representing overseas companies licensed in the BVI. Eleven insurance managers represent the captive insurance companies locally. Nine brokers, representing the BVI insurance risk buyers and seven loss adjusters, are also regulated in the BVI.

The BVI's two locally incorporated insurance companies are very small, reflecting the small local population base of 19,000 people. Their premium income is between US $1million and US $2 million each.

5.3 **Factual assessment**

5.3.1 **Legislation**

The main legislation applicable to insurance is the Insurance Act 1994.

The Insurance Act ("the Act") applies to any person carrying on insurance business of any kind in or from within the BVI. It provides for the licensing of insurers and prohibits any person acting as an insurer unless licensed. The Act also provides that no person shall act as an insurance manager, agent, broker or adjuster unless granted a licence ("certificate of authority")

The Insurance Act contains a number of requirements imposed upon licence holders. These are:

- minimum margins of solvency for general insurance are in line with generally accepted standards based on 20% of net retained premium income for general business up to a net retained premium income of US$5million (subject to a minimum of $200,000). Where the net retained annual premium of the insurer exceed $5,000,000 the prescribed amount is $1,200,000 plus 1% of the amount by which the said net retained annual premium exceed $5,000,000;
- an insurance company cannot transact business in another country or jurisdiction without the prior written approval of the regulatory authority;
- all insurers are required to maintain a principal office in the BVI and appoint an authorised insurance manager resident in the BVI; and
- all insurers must appoint an independent auditor and life insurers must appoint an actuary. Annual independently audited financial statements must also be submitted.

A licensee is required to present to the Commissioner no later than three months after the end of its financial year, an audited statement of accounts.

The Act also includes specific provisions, which relate to insurance managers, brokers and agents and imposes obligations on these professionals. Persons wishing to act as an insurance manager, agent, adjuster or broker must obtain a licence.

5.3.2 **Rules, regulations and guidance notes**

The Insurance Regulations 1995 consist of rules governing licence application form details, the annual statement as well as the form and content of the certificate of actuary. The minimum margin of solvency, allowable assets, valuation of assets and calculation of liabilities are also contained within these regulations.

There have been no guidance notes developed and issued to the insurance industry.

5.3.3 **Supervision - systems and procedures**

5.3.3.1 ***Application process***

All applicants are required to complete a licence application that requires detailed information on shareholders and directors, a complete business plan, financial projections and re-insurance programme. Applicants must also supply background information on shareholders, directors and officers together with the required references.

Background checks are conducted on all shareholders, directors and companies seeking licence approval.

The Commissioner obtains a Certificate of Good Standing from the home regulators if necessary.

5.3.3.2 ***Off-site supervision***

Off-site supervision takes the form of detailed analysis of the annual financial returns and reporting forms. Quarterly returns have been solicited on occasions in the past when closer scrutiny was deemed to be warranted.

The Commissioner reviews business plans at the time of submission. Insurance companies must advise all changes to their business plans.

The Commissioner has commenced the process of obtaining statistical data from its licence holders to enable it to better understand the size of the industry and its profile. This process is currently ongoing.

5.3.3.3 ***On-site supervision***

No on-site supervision is conducted at present.

5.3.4 **Enforcement - systems and procedures**

Section 26 of the Act provides for cancellation of licence by the Governor in Council on the recommendation of the Commissioner on a number of grounds, including contravention of any condition of its licence.

There are no enforcement powers other than cancellation of licence available under the Act. In addition, there are no powers under the Act for the Commission to "police the perimeter".

5.3.5 **Policyholder protection schemes**

No policyholder protection scheme is in place in the BVI.

5.4 **Issues and recommendations**

5.4.1 **Introduction**

Whilst the BVI has an acceptable legislative basis for the regulation of insurance companies, there are a number of areas that should be addressed.

5.4.2 **Statistical returns**

It is our view that there is insufficient information available to allow the Commissioner to identify possible areas requiring attention in his licence holders. Statistical information will enable sound strategies for the prudent regulation of the insurance sector to be introduced and the absence of such information will prevent an assessment of the effectiveness of these strategies.

We recommend that full statistical information should be obtained and that companies must be required to provide information on essential market data including premiums, reinsurance and loss ratios.

5.4.3 **On-site supervision**

There has been a recent move, internationally, towards more on-site inspections for insurance companies, limited in some jurisdictions and well established in others. These inspections do not currently take place in the BVI and with limited resources will be difficult to introduce.

We recommend that because of the resource limitations, priority should be given to the establishment of procedures to obtain information relating to the underwriting policy, reinsurance programme, claims management and reserving policies and record keeping, as a first step towards more effective on-site supervision. This could be done by third party as part of an outsourcing exercise. In order to effectively regulate the sector, it is essential that the Commissioner is aware of each of the points raised above. Once in place, BVI can develop on-site visits further.

Furthermore, initial priority should be given to the inspection of third party captives and domestic insurers.

5.4.4 **Enforcement powers**

There is currently a lack of intermediate enforcement powers (for example, fining and public censure). Furthermore, no powers exist to police the perimeter. We, therefore, recommend that amendment is made to the Insurance Act to:

- increase the powers available to the Commissioner to impose sanctions for a breach of regulations; and
- make a breach of any anti-money laundering code of practice issued grounds for disciplinary action, including, if appropriate, the revocation of a licence.

5.4.5 **Guidance notes**

Guidance notes are generally used to disseminate policy and reporting requirements to insurance companies. Although they lack the legal force of regulations, notes should carry similar weight. We therefore recommend that guidance notes relating to existing regulations, statistical information and off-site procedures be introduced.

We welcome your comments on this site.

Prepared 27 October 2000

6 Securities/investments

6.1 Introduction

There are established international standards in place concerning the regulation and supervision of those involved in the securities and investments sector. The Terms of Reference for this review require us to consider whether the arrangements for the monitoring, supervision and regulation of securities and investments conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

The relevant IOSCO Principles for this Section include:

- the responsibilities of the regulator should be clear and objectively stated (Principle 1);
- the regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers (Principle 3);
- the regulator should adopt clear and consistent regulatory processes (Principle 4);
- the regulator should have comprehensive inspection, investigation and surveillance powers (Principle 8);
- the regulator should have comprehensive enforcement powers (Principle 9); and
- the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme (Principle 10).

It is against the IOSCO standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

For the purpose of this report we have defined securities/investment business as covering the following range of activities:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

This section also covers mutual fund administrators. Legislation and regulation relating to mutual funds are covered in the following section.

Mutual fund administrators do not come within the scope of IOSCO's principles and, therefore, there are no formal international standards in this area. Our evaluation of these administrators is therefore based upon the premise that compliance by administrators with IOSCO principles, as applicable, represents good practice and our recommendations should be read in this light.

6.2 Type and scale of activity

In respect of securities/investments business only administrators and managers of mutual funds are currently regulated. In the BVI, managers and administrators are defined in the Mutual Funds Act 1996 (" the MFA").

As at 1 March 2000, 289 mutual fund administrators and managers had been licensed. The vast majority of these do not have a physical presence in the BVI and are incorporated as international business companies.

Many licensed managers and administrators sub-delegate the undertaking of their functions to a third party either inside or

outside the BVI.

Additionally the BVI licensed managers frequently act as "fee" vehicles and do not undertake any management themselves. In such circumstances the task of management is delegated to another entity which may be in the BVI or elsewhere.

With the exception of the above no other person undertaking investment or securities business in the BVI is subject to regulation and no data is available as to the extent of such activities being undertaken on an unregulated basis.

6.3 **Factual assessment**

6.3.1 **Legislation**

6.3.1.1 ***Introduction***

As stated above no legislation currently exists providing for the regulation of those engaged in securities or investment business (dealing, arranging deals, managing and investment advice) except in relation to carrying on business as a manager or administrator of a mutual fund in or from the BVI.

Additionally no legislation exists criminalising the activities of insider trading and market manipulation.

The requirement for the regulation of managers and administrators of funds is contained within the Mutual Funds Act 1996 and amending legislation in 1997. The Mutual Funds Act came into force on 2 January 1998.

Whilst there is no statutory requirement for a BVI fund recognised under the Mutual Funds Act to have a manager or administrator there is, by implication, such a requirement for registered (that is, Public) funds, as the manager and administrator must be notified to the Registrar at the time of application.

6.3.1.2 ***Activities requiring a licence***

The activities requiring a licence are those of managing or administrating a mutual fund. An administrator is a person who, for consideration provides a fund with administrative services and/or accounting services; or is entitled to provide to funds such services under the laws of a recognised country or jurisdiction.

A manager is a person who for consideration provides a scheme with management services alone or together with investment advice or administrative services; or is entitled to provide to funds such services under the laws of a recognised country or jurisdiction.

These activities are covered if:

- they involve the provision of the service by a BVI constituted entity wherever the service is physically provided or wherever the funds are located; and
- they involve the actual provision of the service in the BVI regardless of where the manager/administrator is incorporated.

Currently there are no licence holders in this latter category. Firms are required to be licensed even where they delegate all activity to a third party. However, firms incorporated outside the BVI who provide management or administration services to BVI funds are not covered by the Mutual Funds Act unless the service is physically provided in the BVI.

6.3.1.3 ***Exemptions from licensing requirements***

Firms incorporated outside the BVI but which have a branch or representative office in the BVI may apply for an exemption under section 22 of the Mutual Funds Act if they are regulated in a recognised country or jurisdiction. No exemptions have been applied for to date.

Furthermore, Managers incorporated in the BVI are exempt from the licensing requirement if they meet the conditions laid down in the Mutual Funds Recognised Managers and Family Trusts Direction. These conditions include:

- The BVI company being controlled by a company entitled to provide investment management services under the laws of a recognised country or jurisdiction;
- the controlling company is of sound repute and is of good standing with the competent authority in the jurisdiction;

and

- activity undertaken by the BVI company is delegated to a licensed administrator or manager in the BVI ("the responsible licence holder").

Unlike the section 22 exemption, this exemption is automatic and need not be applied for. However, the Directions require that, in practice, notification must be provided along with evidence that the conditions set down in the Direction have been satisfied. If satisfactory evidence is not provided then the notification is not accepted and the manager must apply for a licence.

6.3.1.4 ***Activities undertaken outside the jurisdiction***

The nature of the finance sector in the BVI means that the majority of management and administrative activity for funds is carried on outside the territory as the funds themselves are international in nature and the BVI currently has a limited number of local firms providing these services.

Firms undertaking the activities of manager, administrator or custodian outside the BVI are known as "foreign functionaries".

The Mutual Funds Act does not impose specific requirements with regard to the location of the manager, or administrator. However, Section 27(1) of the Mutual Funds Act does provide that the Minister of Finance may impose any terms, conditions, limitations or restrictions upon the issue of a licence/certificate as he may see fit to specify. There has been significant use of conditions in requiring that any functionary appointed must be located either in the BVI or a "recognised" country or jurisdiction.

6.3.1.5 ***Recognised countries and jurisdictions***

The BVI has recognised a number of countries and jurisdictions which it considers provide appropriate levels of regulatory supervision. Foreign functionaries can generally only be located in a recognised jurisdiction or country.

A foreign functionary which is incorporated in a non-recognised country or jurisdiction may also be acceptable, provided the country or jurisdiction is regarded by the Minister of Finance as having a prudent system of regulation and supervision of mutual funds business.

6.3.2 **Regulations**

Regulations can be issued under Section 42 of the Mutual Funds Act and directions under Section 35. The Mutual Funds Act also enables the Minister of Finance to issue a Code of Practice (Section 25(A)). The Code may provide for enforcement mechanisms.

No code has yet been produced.

6.3.3 **Guidance notes**

The Registrar has issued "fit and proper" policy guidelines under Section 3(2)(d) of the Mutual Funds Act. These guidelines are designed to advise applicants of the application process and the requirements for licensing.

6.3.4 **Supervision - systems and procedures**

6.3.4.1 ***Regulatory structure***

Licensing and enforcement powers under the Mutual Funds Act are vested in the Minister of Finance ("the Minister"). Day-to-day supervisory responsibility rests with the Registrar of Mutual Funds. The Registrar's broad responsibility is to supervise managers and administrators of mutual funds. The Registrar is supported by two assistants.

The Registrar is part of the Financial Services Department.

6.3.4.2 ***Licensing***

Application for a licence to be a manager or administrator is made to the Minister along with details of the financial, administration and human resources available for the proposed business.

Vetting checks are performed by the Registrar who makes recommendations to the Minister on the suitability of an applicant.

It is a requirement of the Mutual Funds Act that the Minister may grant licences only to applicants who have demonstrated that they are fit and proper to engage in the business proposed and who have adequate knowledge, expertise, resources and facilities necessary for the proper conduct of their business.

All licence holders are required to appoint an auditor with the exception of a company incorporated or continued as an international business company under the International Business Companies Act which provides services to one private mutual fund or one professional mutual fund and whose business is only to appoint other service providers or to receive fees or both.

The Minister has power to refuse an application if he does not consider it to be in the public interest.

All applications for licensing must provide full details (such as name and address in the case of an individual) of the ultimate beneficial owner(s) of the applicant.

Where an applicant is directly owned by a body corporate or a trust, details must be provided of the country or jurisdiction in which the company or trust is incorporated or constituted and of the beneficial owners or beneficiaries of that company or trust.

Applicants for licensing are advised not to issue bearer shares as this is inconsistent with the disclosure and assessment of the beneficial ownership of an applicant for licensing.

32 applications have been refused on "fit and proper" grounds and 61 applications have been withdrawn since the Mutual Funds Act came into force.

6.3.4.3 ***Requirements concerning delegation***

Where a licence holder wishes to delegate its activities to a third party outside the jurisdiction the Registrar requires details of the third party to enable him to assess whether it has or has available to it adequate knowledge, expertise, resources and facilities necessary for the nature and scope of the business proposed. This requirement is set down in section 24(2) of the Act.

Guidance is incorporated in the licence application form and requires certain documents, such as sub-delegation agreements, to be submitted. Other information on a third party, such as evidence of authorisation in its home country, may be requested on a case-by-case basis by the Registrar if he deems it necessary in order to be satisfied that the licensing standard has been met.

6.3.4.4 ***Ongoing requirements***

The Minister may, by Order, prescribe a Code of Practice directing the holder of a licence to comply with the requirements of the Code which may include matters relating to:

(a) conduct of business;

(b) financial resources;

(c) the giving of notice of specified events;

(d) advertising;

(e) clients' money and custody of investments; and

(f) accounting records and audit requirements.

No Code has yet been issued.

Procedures for on and off-site supervision have not yet been developed.

6.3.5 **Enforcement - systems and procedures**

6.3.5.1 ***Power of the Registrar***

Section 36 of the Mutual Funds Act provides the Registrar with the power to direct any person, to whom the Act applies, to furnish information or to provide access to records, books or other documents relating to the business of that person which, in the opinion of the Registrar, are necessary to ascertain compliance with the Act. Failure to comply is an offence punishable by a fine or a term of imprisonment.

6.3.5.2 ***Code of Practice***

The Code of Practice referred to at 6.3.4.4 above may provide for such enforcement mechanisms as the Minister considers necessary to ensure compliance with the provisions of the Code.

6.3.5.3 ***Cancellation of licence***

The Minister may cancel a licence or may impose new or additional conditions where the holder:

(i) has ceased to carry on business in or from within the Territory;

(ii) has contravened any provision of the Mutual Funds Act, the Regulations or the Code of Practice, or any term, condition, restriction or limitation attached to the holder's certificate or licence, as the case may be;

(iii) has been convicted of an offence under the Mutual Funds Act in any country or jurisdiction;

(iv) has knowingly and wilfully supplied false, misleading or inaccurate information or failed to disclose information required for the purposes of any provision of the Mutual Funds Act or the regulations;

(v) is carrying on business in a manner detrimental to the interests of mutual fund investors or to the public interest; or

(vi) is declared bankrupt or is being wound up or otherwise dissolved.

Where a licence has been revoked the person would be directed by the Registrar to "cease and desist" carrying on business in the Territory. This power can also be used against other non-licence holders. As at 31 March 2000 8 licences had been cancelled. In addition 26 directions to "cease and desist" have been made against non-licence holders considered to be in breach of the Mutual Funds Act.

6.3.6 **Publicly available information**

By virtue of Section 6 of the Mutual Funds Act the Registrar is required to keep a register of licensed managers and administrators.

Information included on the register includes:

- address of place of business and address for service in the BVI;
- name and address of person in the BVI authorised to act as representative and to accept service; and
- address of any place of business outside the jurisdiction.

The register must be available for public inspection on payment of a prescribed fee (US $5).

6.3.7 **Co-operation with other regulators**

The Mutual Funds Act does not have the broad gateway provisions contained in the Bank and Trust Companies Act and the Insurance Act.

There is no provision in the MFA enabling the Registrar to undertake an investigation on behalf of overseas regulators.

Details of the powers of co-operation are contained in Section 3 of this report.

6.3.8 **Investor compensation scheme**

No investor compensation scheme is in operation in the BVI.

6.4 **Issues and recommendations**

6.4.1 **Introduction**

The introduction of a regulatory regime for the managers of mutual funds is positive evidence of the BVI's commitment to move towards full compliance with international standards. It should also be noted that, unlike a number of other jurisdictions, the BVI treat fund administration as a regulated activity. We consider this approach to represent good practice.

The FSD accept that, despite these efforts, the current regulation of securities/investment business in the BVI fails to fully meet the international standards set out by IOSCO. This is principally due to the absence of legislation covering investment business other than in respect of the management of mutual funds.

In addition, the FSD recognise that there are other deficiencies, including the need to establish on and off-site supervision and the lack of a regulatory code, which means that the BVI is currently unable to fully comply with IOSCO Principles in respect of the activities it currently regulates. It should be noted that the BVI have plans to rectify these weaknesses.

6.4.2 **The scope of legislation**

Except where covered by the Mutual Fund Act the BVI do not currently regulate those conducting investment business, including those engaged in the businesses of dealing in investments, arranging deals in investments, investment advice and management.

The current absence of legislation in this area means that IOSCO Principles are not being complied with in respect of this unregulated investment business activity.

The current scale of this activity is unknown and as the BVI seeks to broaden the scope of its financial sector such activity may increase. Therefore, it is, important that it does so within an appropriate regulatory environment. Failure to do so will result in an unregulated activity, not in line with international standards and the risk of investor loss and potential criminal activity.

There is also a need for the BVI to introduce legislation criminalising insider trading and market manipulation. Not only might these offences be undertaken in or through the BVI but also the lack of appropriate laws means that they do not form part of offences covered by the BVI's anti-money laundering laws as they are not a predicate offence (see the anti-money laundering section to this Report for details).

6.4.3 **Exemptions from the requirement to be licensed**

We consider that the principle for granting exemptions to certain types of investment business does not, of itself, breach international standards. Nevertheless the current exemption granted to managers in recognised countries or jurisdictions needs to be amended to ensure that only those subject to proper regulation in their home jurisdiction can gain the full exemption from the requirement to be licensed in the BVI.

We consider that the exemption given in the Mutual Fund Recognised Managers and Family Trust Directive relies upon the overall standard of the regulatory regime in the recognised country and upon the competent authority exercising supervision over the subsidiary granting the exemption. Otherwise no fit and proper assessment will have been made of the exempted manager. This is potentially a risk as, even though the activities have been delegated, some control may still remain with the exempted person.

We also consider that the exemption under Section 22 of the Mutual Fund Act for the branch and representative office of those who are regulated in a recognised country or territory is potentially too wide as it could permit management or administrative activity to be undertaken in the BVI without effective supervisory control if the "home" regulator does not exercise supervision over foreign branches or offices of its licence holder.

We, therefore, consider that where the foreign functionary is regulated in another jurisdiction the BVI reach agreement with the regulator in that jurisdiction (by MOU or other formal process) to ensure that there is regulatory coverage of the appropriate activities and that the BVI are advised of any matters pertinent to their regulatory role.

However, where the functionary does not fall into the above categories it should be subject to licensing and regulation by the BVI.

In the case of administrators an assessment should be made of which recognised countries and jurisdictions regulate this activity. Where there is no regulation consideration should be given to either direct licensing or requiring a contractual arrangement between the fund and administrator providing access to the administrator by the Registrar so enabling on-site

supervision to be undertaken.

6.4.4 **Delegation by a licence holder**

It is important that, where the licence holder delegates its functions to a third party the Registrar is able to ensure that these functions are undertaken properly. Whilst the Registrar may be able to use moral suasion or the threat of the revocation of a licence we consider that unless the delegated party is subject to regulation in its own jurisdiction it would be preferable that the contract between the licence holder and the person undertaking the delegated activity contains a clause permitting the Registrar access for the purpose of conducting on-site inspections.

We recommend that future applicants be required to have this permission included in their sub-contracting agreement and that existing licence holders are given a specific time to amend their agreements accordingly.

6.4.5 **Supervision**

There is a need to develop a supervisory system that reflects these issues. In particular this needs to address the supervisory process for functions delegated to third party managers.

The nature of the licence holder base in the BVI, particularly the number of licence holders without a real presence in the territory, makes the effective use of inspection powers difficult, particularly those relating to on-site supervision. This problem is exacerbated by the fact that many managers are not carrying on fund management or administration themselves but have delegated the task to a third party, often outside the BVI.

At present these issues have not been fully addressed and therefore, in the case of managers, IOSCO Principles 8, 9 and 10 are not being complied with.

We consider that any on-site supervisory regime developed for managers should pay particular attention to the methodology for supervising licence holders with no real presence in the BVI.

6.4.6 **Code of Practice**

In addition to the above, the lack of a Code of Practice governing the way in which a licence holder conducts its business means that IOSCO Principle 23 is not being fully complied with.

We consider that a code of practice be issued covering, *inter alia*:

- conduct of business;
- financial resources;
- the giving of notice of specified events;
- advertising;
- clients' money and custody of investments; and
- accounting records and audit requirements.

There is also a need to make a breach of any anti-money laundering Code of Practice grounds for disciplinary action including, where appropriate, the revocation of a licence. We recommend that such a requirement is introduced. This will allow regulatory action to occur even where there is no criminal prosecution for breach of the code.

6.4.7 **Enforcement powers**

Section 36 of the Mutual Funds Act provides the Registrar with considerable powers not only to investigate regulatory breaches by licence holders, but also to "police the perimeter", as the powers are not limited to licence holders. To ensure the effectiveness of the section it does, however, need expansion to ensure that such powers extend to the Code of Practice and Directions.

We therefore recommend that the enforcement powers under the Act are amended to specifically cover the Code of Practice and Directions.

Furthermore, we recommend there should be a number of additional enforcement measures available. These include:

- the power of the Registrar to seek the winding up of a licence holder in the public interest;
- the power to declare an individual not to be "fit and proper" to be a controller officer or director of a licence holder;
- the power to fine;
- the power to seek injunction to prevent a breach or continued breach of the Act; and
- the power to appoint a temporary manager to manage a licence holder.

These would enable the Registrar to have the comprehensive enforcement powers required under IOSCO Principle 9 and deal with a situation of licence holder default, as required by IOSCO Principle 24.

6.4.8 **Public register**

We recommend that the requirement for a person to pay a fee to inspect the register is inappropriate and deters transparency. This should be removed.

We also consider that restricting public access to the register to physical inspection during normal office hours inappropriate given the international nature of this activity.

Whilst this is not an international standard it would be an example of good practice if, given the international nature of the BVI's business, the BVI makes some or all of this information available on the world wide web.

We welcome your comments on this site.

Prepared 27 October 2000

7 Mutual Funds

7.1 Introduction

There are established international standards in place concerning the regulation and supervision of collective investment schemes. The Terms of Reference for this review requires us to look at whether the arrangement for the regulation of collective investment schemes conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

Among the IOSCO Principles there are specific principles relating to collective investment schemes; these are:

- that the regulatory system should set standards for the licensing and the regulation of those who wish to market or operate a collective investment scheme (Principle 17);
- the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client money and assets (Principle 18);
- regulation should require (full, timely and accurate disclosure of financial results and other information) which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme (Principle 19); and
- regulations should ensure that there is a proper and disclosed basis for asset valuation and the pricing and redemption of units in a collective investment scheme (Principle 20).

Other Principles, particularly regarding the regulator, enforcement and co-operation also apply to the regulation and supervision of schemes.

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

7.2 Type and scale of activity

Legislation regulating and supervising mutual funds in the BVI came into force in January 1998. Under this legislation there are three categories of mutual fund. These are public, private and professional funds. These are defined below.

Funds may be in trust, corporate or limited partnership form.

As of February 2000 there were:

- 139 public funds; and
- 1,545 non-public funds (split approximately equally between private and professional).

The FSD does not have details of the size of funds under management as there is no requirement to report fund size.

7.3 Factual Assessment

7.3.1 Legislation

Mutual funds operate under the Mutual Funds Act 1996 ("MFA") and amending legislation introduced in 1997. This Act came into force on 2 January 1998.

The MFA makes separate provisions for public funds which are required to be registered and non-public funds which are required to be recognised. Non-public funds are divided into private and professional.

7.3.1.1 *Public funds*

The MFA defines a public fund as one which is not a private or professional fund. Public funds must be registered by the Governor in Council in order to do business in or from the BVI. There is power under the MFA to grant or refuse registration. The power to grant (but not refuse) registration has been delegated to the Registrar of Mutual Funds ("Registrar").

An application for registration requires the submission of details about the nature of the fund's business and information on its principal officers.

There is no specific requirement in the MFA for public funds to have a BVI manager or administrator. However the Registrar views that the requirement is implied that the applicant must notify the Registrar of the proposed manager and administrator. A public fund must also have a custodian which is functionally independent of its manager or administrator. The fund must have a name which is not undesirable or misleading.

The MFA requires the following in respect of public funds:

- maintenance of adequate accounting records and annual audited financial statements available for the Registrar's inspection;
- the production and filing of a prospectus which has been authorised by the fund's directors and which contains information sufficient to enable an informed investment decision; and
- the filing of an annual certificate of compliance from the competent regulator in any other jurisdiction where the fund is regulated to carry on business.

Once a public fund has been registered, a certificate of registration is issued by the Registrar. The certificate may be subject to certain terms and conditions.

7.3.1.2 *Professional and private funds*

The MFA defines a private fund as one which has less than 50 investors or one whose shares are made available only on a private basis, such as a restricted offering made to a small number of specified persons or by reason of a private or business connection between the parties.

A professional fund is defined as one which is made available only to professional investors, the majority of whom must have invested at least US $100,000 in the fund. Professional investors are defined as persons whose business involves dealing in property of the same kind as the fund or individuals who have signed a declaration that they have net worth over $1 million and are prepared to be treated as professional investors.

The MFA requires private and professional funds to be recognised by the Minister of Finance, whose power has been delegated to the Registrar. Recognition is granted upon the submission of proof of lawful constitution and that the fund falls within the respective category. There appears to be no provision in the MFA to refuse recognition where the necessary information has been provided.

Funds which are constituted outside the BVI but are carrying on business in the territory are regarded as foreign funds and are required to provide the same information as the BVI funds in order to be recognised. They must also provide a description of the business being carried out.

7.3.2 **Regulations**

A number of regulations have been issued under the MFA.

7.3.2.1 *The Mutual Funds (Recognised Managers and Family Trusts) (Exemption) Direction 1997*

This Direction provides exemption from the requirement to hold a licence. Broadly the exemption is for managers owned by authorised institutions in another (recognised) jurisdiction and whose business is delegated to a BVI licensed manager or administrator.

An exemption is also granted for a fund maintained by a group of family trusts provided certain conditions are met (for example, no solicitation).

7.3.2.2 ***The Mutual Funds (Fees) Regulations 1997***

This details the fees payable in respect of The Mutual Funds (Recognised Managers and Family Trusts) (Exemption) Direction 1997.

7.3.2.3 ***The Mutual Funds (Foreign Funds and Audit (Exemptions)) Directions 1998***

This Direction provides exemption for funds constituted outside the BVI, which have a BVI manager or administrator, from the requirement to be registered as a public fund or recognised as a private or professional fund.

Additionally a company incorporated or continued as an international business company under the International Business Companies Ordinance which provides services to one private mutual fund or one professional mutual fund and whose business is only to appoint other service providers or to receive fees or both, is exempted from the requirement to appoint an auditor.

7.3.2.4 ***Public Funds (Sub-class) Regulations 1998***

This Regulation created a new class of public fund, the selective public fund. A selective public fund is one where all interests in the public fund are offered by a person who is entitled to provide investment services (by whatever name called) under the laws of the BVI or a recognised Country or Jurisdiction and that person:

(a) has a written agreement with the investor which covers the offering of an interest in the fund; and

(b) has assessed the suitability of the fund with regard to the agreement and the investment objectives of the investor.

The Regulations do not however require that the person is subject to authorisation.

There are no selective funds currently in operation.

7.3.2.5 ***The Mutual Funds (Professional Fund) Regulations 1998***

This provides transitional arrangements for professional funds in existence when the MFA came into force.

7.3.2.6 ***Other regulations***

Section 42 of the MFA provides for the introduction of regulations for a public fund covering the:

- constitution, powers and duties of the manager, administrator and custodian;
- issue and redemption of shares;
- appointment, removal and powers and duties of auditors;
- restriction or regulation of investment and borrowing powers;
- preparation of periodical reports;
- rights of the investor; and
- contents of the constitutional documents.

No regulations have yet been introduced in respect of the above.

Similarly there are no regulations concerning the content of a prospectus for a public fund, although there is an enabling power contained in Section 42 to introduce regulations in this area. Currently, the Registrar checks the prospectus against internal guidelines on content.

7.3.3

Guidance notes

The Registrar has the power to issue Policy Guidelines pursuant to Section 3 (2) (d) of the MFA. Three have so far been issued (in December 1997, January 1999 and October 1999).

The first guidance note provided interpretations of the MFA in areas where clarification was considered desirable such as the meaning of the requirement for the custodian to be functionally independent from the manager.

The second gave guidelines on the "fit and proper" test for licensing.

The third covered various miscellaneous issues including clarification that bearer shares are not acceptable for applicants.

7.3.4 **Supervision - systems and procedures**

7.3.4.1 ***Regulatory structure***

Supervisory responsibility for mutual funds rests with the Registrar of Mutual Funds. The Registrar's broad responsibility is to supervise mutual funds, managers and administrators. The Registrar is assisted by two deputies.

The Registrar is part of the Financial Services Department.

FSD is a founder member of the Offshore Group of Collective Investment Scheme Supervisors. The Registrar is currently Secretary of the Group.

7.3.4.2 ***Application process***

Public funds

An application for a public fund must provide details of the names, place of birth and citizenship of the directors, general partners and custodian of the proposed fund. A police clearance certificate and references must also be provided. An applicant must also provide the names, addresses and business activities of each of the funds' managers, administrators, investment advisers and custodians together with responses to questions relating to their fit and proper status.

The Registrar maintains a database against which applications are checked and where an applicant or its functionaries are regulated in another jurisdiction, references are sought from the regulator in that jurisdiction.

Public funds must also provide a copy of their prospectus to the Registrar.

The Governor in Council has discretion to grant or refuse an application. However he must refuse registration where the fund:

- has a misleading or undesirable name;
- does not have a custodian that is functionally independent from the manager; or
- has been determined not to be in the public interest.

There is no statutory provision within the Mutual Funds Act formally requiring an applicant to be "fit and proper" although an assessment of "fit and proper" is undertaken by the Registrar. The power to grant (but not refuse) applications has been delegated to the Registrar.

Professional and private funds

Whilst a private fund requires prior approval by the Registrar, a professional fund can operate for 14 days without being recognised.

An application for a professional fund must provide proof of:

- lawful constitution, and
- fulfilment of the criteria for classification as a non-public fund.

There is no requirement regarding submission of details of directors or officers. However, the requirements concerning details of the manager, administrator, adviser and custodian are the same as for public funds.

Provided the necessary documentation has been supplied there is no discretion granted to the Registrar regarding authorisation and the scheme must be recognised. However, recognition may be granted subject to conditions.

As of 31 March 2000, 7 non-public funds had been refused recognition since the MFA came into force on grounds that they did not provide satisfactory evidence of fulfilment of the recognition requirements of the MFA and 44 applications had been withdrawn by the applicant.

7.3.4.3 ***Ongoing supervision***

Public funds

The MFA provides that the Registrar or any person acting under his authority should have access to records, books and documents relating to the operations of a person carrying on business under the MFA.

Public funds are required to maintain, in the BVI, adequate accounting records in respect of each financial year and have such records audited by an auditor approved by the Registrar.

Such an audit must be in accordance with generally accepted auditing standards. The Registrar does not currently require the automatic submission of audited accounts to him. However, earlier this year the Registrar requested submission of the latest audited accounts together with a copy of the audit report. This request was designed to assist in the ongoing supervision of regulated entities.

There is currently no programme of off-site or on-site supervision.

The MFA also requires an annual certificate of compliance to be obtained by the fund from the competent authority in any jurisdiction outside the BVI in which the fund is regulated to carry on business. Very few of these have been supplied in practice. It is not clear whether this failure is a result of the funds failing to request a certificate or the other regulator failing to supply it.

Private/professional funds

There is no ongoing supervision of private or professional funds.

7.3.5 **Enforcement - systems and procedures**

7.3.5.1 ***Powers of the Registrar***

Section 36 of the MFA provides the Registrar with the power to direct any person to whom the MFA applies to furnish information or to provide access to records, books or other documents relating to the business of that person which in the opinion of the Registrar are necessary to ascertain compliance with the MFA. Failure to comply is an offence punishable by a fine or imprisonment.

The Registrar also has powers under Section 3 (2)(d) of the MFA to issue directions for the purposes of the MFA or regulations made under it.

As at 31 March 2000, 11 funds had been directed, under those powers, to "cease and desist" carrying on business in the BVI. We have been advised by the Registrar that these directions were complied with.

7.3.5.2 ***Other enforcement powers***

The MFA does not provide for other enforcement powers such as:

- the ability to petition the Court to wind up a mutual fund in the public interest;
- the power to fine;
- the power to enter into an enforceable settlement or accept a binding undertaking (although this may be covered by the use of directions); or
- the power to appoint a custodian to protect the assets of a mutual fund.

7.3.6 **Investor compensation scheme**

No investor compensation scheme is in place in BVI in relation to mutual funds.

7.4 **Issues and recommendations**

7.4.1 **Introduction**

The establishment of a legislative and regulatory regime in 1998 has significantly improved the BVI's level of supervision of mutual funds. This legislation was particularly important because of the number of the BVI companies which are acting as mutual funds.

Whilst the legislation was introduced later than in a number of other leading offshore centres, it, nevertheless, contains a number of provisions which significantly assist the BVI in moving towards achieving international standards in the regulation and supervision of mutual funds.

There are, however some areas where improvements are needed to meet IOSCO Principles, including off and on-site inspection and the introduction of regulation for public funds. We are advised that the BVI intends to address these deficiencies and we support their commitment to such improvements.

The areas where we consider further development is needed are detailed below.

7.4.2 **Public funds**

It is important to recognise that the vast majority of the BVI funds are non-public. Therefore whilst the BVI's regulation of them is not to IOSCO standards (as IOSCO does not distinguish between public and non-public funds), the approach taken by the BVI is similar to that taken to non-public funds by many other jurisdictions. Indeed, unlike the BVI, a number of jurisdictions exercise no regulatory control over certain non-public funds.

Our evaluation, therefore, draws a distinction between public and non-public funds. For the purposes of the BVI, we consider that private and professional schemes are non-public.

We nevertheless consider that as a matter of good practice non-public funds should be subject to initial vetting and that enforcement and supervisory powers should exist. However in line with general international practice for non-public funds there need be no specific requirements along the lines envisaged by IOSCO Principles 18, 19 and 20 because of the nature of the investors involved.

7.4.3 **Ongoing supervision**

7.4.3.1 ***Off-site monitoring***

We consider that off-site supervision of public funds should be designed to enable the Registrar to assess the activities of a fund and to identify potential risk areas which may be evidence of a regulatory breach or increase the likelihood of such a breach in the future. This should be achieved through a formal documented review programme.

Such a programme should include the receipt and monitoring of the annual audited accounts of funds and details of fund size and composition on a quarterly basis. There should also be a requirement for breaches of the regulations or the fund's constitutional documents to be notified to the Registrar.

The details of fund composition should be compared against the fund's constitutional documents to ensure that the composition is in accordance with the funds objectives and asset holding policies.

We agree with the BVI that the introduction of an off-site monitoring programme must, therefore, be a priority. Until such a programme is introduced IOSCO Principle 10 is not being fully adhered to.

As part of off-site supervision the BVI should also introduce an ongoing requirement for all public funds to seek approval from the Registrar of any proposed changes to functionaries, officers or directors together with an explanation for the change. In the case of non-public funds these should be subject to prior notification.

Such approval/notification will enable fit and proper vetting to be undertaken of the new functionary etc. Furthermore as changes may be indicative of potential risks to investor protection (for example, the dismissal of a director for fraudulent conduct), the notification will allow the Registrar to conduct any necessary investigations.

The MFA contains a requirement for an annual certificate of compliance to be obtained from the competent authority in any jurisdiction outside the BVI in which the fund is regulated to carry on business. As very few of these have been supplied, we suggest that the Registrar should assess whether this failure is due to the funds failing to obtain the certificate or reluctance of the regulator in the other jurisdiction to supply them.

7.4.3.2 ***On-site supervision***

In order to assess areas such as the accuracy of pricing and compliance with regulations we consider on-site visits of the relevant functionaries of a public fund is necessary. This will bring the BVI into compliance with IOSCO Principles.

Once the regulatory structure is in place the Registrar should commence on-site inspection visits to verify compliance.

In the case of non-public funds, we do not consider routine on-site inspections necessary to meet international standards and therefore the Registrar's current powers to undertake an investigation if one is required are sufficient to meet the general principle of protection of investors.

7.4.4 **Regulations**

The BVI recognise that there is a need to introduce regulations in relation to public funds. This is necessary to ensure that such funds are operating in line with IOSCO Principles relating to mutual funds.

In order to meet these international standards these regulations should cover *inter alia*:

- the segregation and protection of client assets (IOSCO Principle 18); and
- the content of the prospectus, including information required to enable a prospective investor to assess the suitability and the value of their investment as well as the basis of valuation and pricing and redemption of units (IOSCO Principle 19 and 20).

The regulations should also cover requirements regarding the retention by the fund of such records as are necessary for appropriate supervision to be undertaken (for example dealing and accounting records). As on-site inspections and investigations are, inevitably, partially dependent on a review of records it is important that there should be a requirement that the necessary records are maintained.

For the same reasons appropriate record keeping requirements should also be imposed on non-public funds.

7.4.5 **Registration of an application (public funds)**

The Registrar undertakes fit and proper checks and these are detailed in published guidance notes. However, the MFA does not formally require such a check. We consider it desirable that the Act requires the Registrar to place "fit and proper" checks on a statutory footing by amending the legislation to reflect actual practice.

Such a change would also bring this part of the MFA in line with Section 24 of that Act, which requires managers and administrators to be "fit and proper". This amendment should be made at the same time as the other amendments to the MFA recommended in this Report.

7.4.6 **Recognition of private and professional funds**

We consider that certain additional changes should be made to the BVI's regulation and supervision of non-public funds.

The lack of discretionary powers in the Mutual Funds Act for the Registrar to decline to recognise a fund, apart from where there is a failure to meet the statutory requirements detailed above, is not in accordance with the principles of good practice. This amendment should be made at the same time as the other amendments to the MFA recommended in this Report.

Furthermore we do not believe that the current information required as part of an application is sufficient for the Registrar to be adequately aware of the activities of a non-public fund. In particular the lack of a requirement to file details of the proposed directors/partners is a weakness as it does not allow for any fit and proper checks to be undertaken nor for any database of activity to be developed allowing the Regulator to ascertain the other activities of directors who are the subject of regulatory investigation in the BVI or elsewhere.

7.4.7 **Enforcement powers**

Section 36 of the Mutual Funds Act, which contains the investigation powers of the Registrar, provides the Registrar with considerable powers not only in respect of regulatory breaches by any person to whom the Mutual Fund Act applies. These powers allow him to "police the perimeter", as his powers are not limited to registered and recognised funds.

To ensure the effectiveness of Section 36 in respect of non-licence holders the section does, however, need expansion to

ensure that such powers extend to Directions imposed by the Registrar, as these are not expressly referred to in the Section. We, therefore, recommend that this section is amended accordingly.

Additionally, whilst the Registrar does have a reasonable number of enforcement powers he does not have the full range detailed in the IOSCO Principles. Therefore, there should also be a number of additional enforcement measures available to fully meet IOSCO Principle 9. These are:

- to seek the winding up of a scheme in the public interest;
- to fine a scheme for breaches of the Mutual Funds Act or regulations;
- to petition the court to appoint a custodian to manage the assets of a scheme;
- to require the substitution of any service provider to the scheme; and
- to enter into enforceable settlements and accept binding undertakings if this cannot be achieved through the use of directions.

We recommend that the changes to the MFA are given legislative priority.

7.4.8 **Other amendments to the Mutual Funds Act**

Whilst we support the Registrar's interpretation of the MFA that a public fund should have a manager and administrator we consider that, to ensure certainty, the MFA should be amended to formally clarify that this is a requirement.

7.4.9 **Regulations**

Public Class (sub-fund) regulations 1998

We consider the definition of selective funds is too wide as it allows selective funds to be offered by persons "entitled" to provide investment services rather than restricting the exemption to persons actually licensed/authorised to do so. This means that there may be no regulatory body capable of verifying that the obligations placed upon the exempted person concerning suitability are actually being followed.

We, therefore, recommend that this exemption should only be available where the exempted person is subject to a regulatory regime capable of verifying that the suitability obligation is being complied with.

We welcome your comments on this site.

Prepared 27 October 2000

8 Companies

8.1 Introduction

As recognised by the Terms of Reference (TOR), there are no specific international standards concerning the regulation and supervision of companies. However, there are a number of international standards concerning the operation and management of companies. These include the OECD "Principles of Corporate Governance", the G7 "Report on Transparency and Accountability" and the IMF "Guide to Progress in Strengthening the Global Financial Architecture". There is also the work of the International Accounting Standards Committee.

Whilst other international standards exist, these primarily relate to particular financial services activities such as banking, securities and insurance and many of their requirements are not directly applicable to ordinary trading and holding companies.

The OECD Principles cover:

- the rights of shareholders;
- the equitable treatment of shareholders;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board of directors.

The Guidance Notes cover the following additional issues with regard to companies:

- the ability of law enforcement and regulatory authorities to identify, quickly and efficiently, the shareholders and directors of a company and the beneficial owners of a company's shares;
- the ready availability of financial information relevant to the activities of companies to law enforcement and regulatory authorities;
- the requirements concerning accounting disclosure and auditing practice, particularly where there are obligations to third parties;
- the circumstances in which accounts should be produced and when accounts should be made public;
- the investigative and enforcement powers available to the Overseas Territory; and
- standards of corporate governance.

The TOR and the Guidance Notes cover companies and company service providers together. However, we consider that it is useful to consider them separately, which we have done in this Report.

We consider that the regulation of company service providers is the most practical and effective way of deterring the abuse of company structures and of ensuring that relevant information is available to law enforcement and regulatory authorities. This approach is in accordance with the views expressed in the recent UK Home Office "Review of Financial Regulation in the Crown Dependencies" (Section 13.4.1). Nevertheless, there are areas where the requirements imposed upon companies themselves need to be enhanced.

In considering these enhancements, we have not undertaken a review of company or insolvency law as a whole. The TOR do not require us to do this. Instead we have assessed the legislation and regulation of companies in the BVI against the international standards referred to above and the criteria in the Guidance Notes summarised above.

8.2 **Type and scale of activity**

The BVI is the world's largest centre, for the incorporation of international business companies, almost 360,000 international business companies having been incorporated over the last 15 years.

Two types of company may be incorporated in the BVI; a Company Act ("CA company") incorporated under the Companies Act; and an international business company ("IBC") incorporated under the International Business Companies Act. CA companies can be either resident or non-resident.

CA companies are not considered to be attractive offshore vehicles, probably due to the more onerous filing requirements imposed upon them and the fact that the Companies Act is out of date. As a result, CA companies tend to be used for domestic purposes only and relatively few are incorporated each year.

IBCs are used exclusively as offshore vehicles.

Legislation enabling the incorporation of IBCs was first enacted in 1984, although it was not until the late 1980s that the BVI IBCs became popular as offshore vehicles.

The table below shows the numbers of IBCs and CA companies incorporated in each of the last three years and the total incorporated to date.

Type of Company	**1997**	**1998**	**1999**	**Total to Date**
IBCs	50,104	43,622	54,059	358,045
CA Companies	170	179	213	9,561

Approximately 250,000 IBCs are active, the balance having been liquidated or struck off the Register, though it should be noted that it is difficult to give an accurate figure on struck off companies as they are being restored daily and can be restored at any time.

Although precise figures are not available, the BVI Government considers that the most important market for IBCs is Hong Kong and the Far East but that South America and Europe are also significant markets.

No statistical information is available concerning the uses to which IBCs are put. However, typical uses include investment, asset holding, capital market structures and mutual funds.

8.3 **Factual assessment**

8.3.1 **Legislation**

8.3.1.1 ***Introduction***

As stated, there are two pieces of corporate legislation in the BVI, the Companies Act and the International Business Companies Act. Both pieces of legislation are administered by the Registrar of Companies appointed under the Companies Act ("the Registrar").

8.3.1.2 ***The Companies Act ("CA")***

CA companies

A CA company may be:

- a company limited by shares;
- a company limited by guarantee; or
- an unlimited company.

Subject to any restrictions in its memorandum of association, a CA company may carry out any lawful object. A CA company, may, therefore carry on business and hold property both within and outside the BVI.

As stated, a CA company is classified either as a resident or a non-resident company. However, the distinction between the two types of company is only significant for fiscal and fee purposes and is not relevant for the purposes of this Report.

A CA company must have a registered office in the BVI, notice of which must be filed with the Registrar. The address of the registered office is available to the public through a company search.

The CA does not require the appointment of a registered agent.

A CA company which by its articles, restricts the right to transfer its shares, limits the number of members to 50 and prohibits any invitation to the public to subscribe for shares is a private company. A CA company which does not qualify as a private company is a public company.

Public companies are required to file audited accounts on an annual basis (section 49). However, there is no restriction on who may be an auditor, except in the case of regulated companies.

Foreign companies

A company incorporated outside the BVI which establishes a place of business within the BVI, (referred to as a "foreign company") must, within one month of doing so, file with the Registrar for registration under section 235A of the CA.

8.3.1.3 ***International Business Companies Act ("IBC Act")***

Definition of an IBC

An IBC is defined as a company which does not:

- carry on business with persons resident in the BVI;
- own an interest in real property in the BVI;
- carry on banking business, trust business, insurance business or company management business, unless it is licensed under the BTCA, the IA or the Company Management Act ('CMA') respectively; or
- carry on business of providing the registered office or registered agent for companies incorporated in the BVI.

The IBC Act permits a number of activities, which could be construed as carrying on business with a person resident in the BVI, but which are ancillary to its main activities, to be excluded from the definition.

Other provisions

An IBC may only be incorporated as a company limited by shares.

An IBC must have a registered office and a registered agent in the BVI. The duties of a registered agent are not set out in the IBC Act. However a registered agent must be a person holding a licence under either the CMA or the BTCA.

The Registrar is required to maintain a register of licensed registered agents.

To ensure that IBCs do not remain on the Register without a registered agent, the IBC Act specifies a procedure to be followed where a registered agent wishes to resign or has his licence revoked or dies. If the IBC does not appoint a new registered agent in the place of the registered agent who has ceased to act, it will be struck from the Register by the Registrar.

There is no requirement for an IBC to prepare or file financial statements or to have its accounts audited.

8.3.2 **Regulations, rules and guidance notes**

No regulations, rules or guidance notes have been issued under either the CA or the IBC Act.

8.3.3 **Supervision - systems and procedures**

8.3.3.1 ***Regulatory structure***

The Companies Registry has 33 staff including the Registrar and 4 Assistant Registrars. The Registry has the benefit of a computer system that records basic company and IBC information in a database. A programme to scan all documents filed in respect of IBCs is under way and, we are advised, should be completed within the next year to 18 months.

The Registrar is responsible for maintaining the registers of companies and IBCs and for registering documents filed.

Although some basic checks may be undertaken, this is essentially a recording function.

As the Registrar's role is not a regulatory one, there is little supervision of either CA companies or IBCs. Aside from filing requirements, the Registrar is only required to maintain the register of registered agents and ensure that only those registered agents who are licensed under the CMA or BTCA act as the registered agent of an IBC.

8.3.4 **Enforcement - systems and procedures**

8.3.4.1 ***Introduction***

Both the CA and the IBC Act contain a number of enforcement powers which are described below.

8.3.4.2 ***Inspection***

CA companies

The Governor in Council may, on an application made for good reason by the requisite number of members of a CA company, appoint an inspector to examine the affairs of the company.

IBCs

There are no provisions in the IBC Act for the appointment of an inspector of an IBC.

8.3.4.3 ***Striking off***

CA companies

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation he must strike the company off the register of companies in accordance with the procedure laid down in the CA. The Registrar regards cessation of the filing of annual returns as a prime indication that the company has ceased to carry on business.

IBCs

The Registrar must strike an IBC off the register of IBCs in accordance with the procedure laid down in the IBC Act where;

- it fails to appoint a new registered agent on the resignation or disqualification of its registered agent;
- it fails to satisfy the requirements for an IBC; or
- it fails to pay its licence fee within the specified time period.

8.3.4.4 ***Winding up***

The Registrar does not have the power to petition for the winding up of either a CA company or an IBC on the grounds of public interest.

8.3.5 **Public availability of information**

8.3.5.1 ***CA companies***

In respect of CA companies, the following documentation is held by the Registrar and is available for public inspection:

- the memorandum and articles of association of the company;
- all annual returns filed by the company, which includes a list of the directors, officers and shareholders of the company;
- any resolutions altering or modifying the memorandum and articles of association; and
- routine correspondence between the company and the Registry.

The accounts of public companies are available to the public once they have been filed with the Registrar.

The register of members which a company is required to keep at its registered office is also available for public inspection

(see below).

8.3.5.2 ***IBCs***

In respect of IBCs, the following documentation is held by the Registrar and is available for public inspection:

- the memorandum and articles of the IBC;
- any other articles, for example, of merger, dissolution or continuation;
- any resolutions concerning an amendment to or modification of the memorandum or articles including, for example, changes of registered office or registered agent and reductions in capital;
- copies of any registers that the IBC has opted to file with the Registrar; and
- routine correspondence between the company's registered agent and the Registry concerning the company.

8.3.6 **Non-public information**

8.3.6.1 ***CA companies***

A CA company is required to keep the following records:

- a register of members;
- a register of directors; and
- a register of mortgages.

The registers of members and directors must be kept at the registered office of the company. There is no requirement that the register of mortgages is kept at any particular location.

Any person may inspect the register of members and a member or creditor may inspect the register of mortgages. The CA does not provide for the inspection of the register of directors.

8.3.6.2 ***IBCs***

Non-routine correspondence between the registered agent of an IBC and the Companies Registry is not placed on the company file but is filed on the registered agent's file. This correspondence is not available for public inspection.

An IBC must maintain the following registers, books and records:

- a share register;
- such accounts and records as the directors consider necessary or desirable to reflect the financial position of the company;
- minutes of meetings of directors and members and committees of directors, officers and members; and
- copies of all resolutions of directors and members and committees of directors, officers and members.

The share register must be kept at the registered office. All other books and records may be kept at such place, within or outside the BVI, as the directors resolve. There is no requirement for a written record of the location of the books and records to be kept at the registered office.

A member of an IBC has a right in furtherance of a "proper purpose" to inspect the share register and the other records and documents required to be kept by an IBC at its registered office. There is no public right to access.

8.3.7 **Directors**

The CA does not provide for the appointment of directors of a CA company or for a director's responsibilities or duties.

An IBC must have one or more directors, the first of whom is appointed by the subscribers to the memorandum. Corporate directors are permitted. An IBC is not required to maintain a register of directors nor to file details of its directors with the

Registrar.

There are no provisions enabling an individual to be disqualified from being a director of a company on the grounds that he is not fit to be a director of a company.

8.3.8 **Beneficial ownership**

There is no legal requirement under either the CA or the IBC Act for the beneficial owners of shares in a CA company or an IBC to be notified to the company, the registered agent or to the Registrar.

8.3.9 **Bearer shares**

A CA company may issue share warrants to bearer.

Subject to any limitations in its memorandum or articles of association, an IBC can issue bearer shares.

As there is no requirement for IBCs to file details of shareholders, it is impossible to ascertain the proportion of IBCs which have issued bearer shares. Nevertheless, it is clear from our discussions with representatives of the financial services industry in the BVI that bearer shares are issued, especially to clients from Central and South America.

8.3.10 **Insolvency**

Part IV of the Companies Act provides for the winding up of CA companies.

The IBC Act details the provisions for the winding up and dissolution of solvent IBCs. An insolvent IBC is wound up in accordance with the provisions in the CA.

Under section 206 of the CA there is a power to make winding up rules, however none have been made.

8.4 **Issues and recommendations**

8.4.1 **Introduction**

We have not undertaken a detailed review of the CA or the IBC Act as this is beyond our TOR. Therefore, our specific comments and recommendations concerning the CA and the IBC Act should not be taken as being the only amendments which may be required. However, we have reviewed those aspects of the legislation which bear directly on our TOR and taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

From our overview it is clear that the CA is an out-of-date piece of legislation. We are advised that it is based on the companies legislation which was in force in the UK prior to the Companies Act 1948, ie the Companies Act 1929. The CA lacks many of the features found in a modern piece of companies legislation. Based on our overview, we consider that the CA is in need of review. It falls short of what one would expect of a modern piece of corporate legislation.

For the reasons set out in the following paragraphs, we are of the view that the IBC Act is also in need of review as it does not comply with good practice standards.

8.4.2 **Companies**

8.4.2.1 ***Public and publicly traded companies***

The preamble to the OECD Principles states that "The Principles focus on publicly traded companies". Similarly, we consider that the G22 Report and the IMF Guide are primarily focused on public and publicly traded companies.

Public companies under both the CA and the IBC Act can be publicly traded and we consider that, where they are so traded, they should be subject to the OECD Principles, together with the G7 and IMF standards.

There are two views which can be taken of this. The first is that a stock exchange should not list a company from a jurisdiction whose companies legislation fails to meet the Principles. The second is that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework (taking the legislation and case law together) fully meets the Principles and the G7 and IMF standards.

In our opinion, although the first view is undoubtedly correct, a jurisdiction should not rely on exchanges in other jurisdictions to "police" the Principles on its behalf. In our view, good practice dictates that a jurisdiction which permits its

companies to be publicly traded should ensure that its legal framework complies with international standards. We consider that the same standards should apply where the shares of a company can be offered for sale to the public, even if those shares are not publicly traded.

Furthermore, the recommendations of the G22 Working Group on transparency and accountability include a recommendation that national standards for disclosure should reflect five basic elements: timeliness, completeness, consistency, risk management and audit and control processes.

In the circumstances, we consider that public companies registered under the CA and IBCs which are publicly traded or whose shares may be offered to the public should be subject to a legal framework which meets the Principles.

The CA is an outdated piece of legislation which does not incorporate the matters envisaged by the Principles, such as adequate controls over the issue of prospectuses. We consider that the CA should be reviewed and amendments made to bring it into compliance.

The IBC Act should be amended to make the CA provisions on public companies applicable to IBCs whose shares may be offered to the public or whose shares are publicly traded.

8.4.2.2 ***Private CA companies and IBCs***

The preamble to the OECD Principles states that the Principles "to the extent that they are deemed applicable might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises".

In respect of IBCs, whose shares may not be issued to the public (which, although there is no distinction between private and public IBCs in the IBC Ordinance, we call "private IBCs") and private CA companies we have assessed those aspects of the Principles which it is reasonable to apply.

We consider that the following sections of the Principles should, in the most part, apply to private CA companies and private IBCs:

- rights of shareholders (section I);
- equitable treatment of shareholders (section II); and
- responsibilities of the Board (section IV).

We consider that both the CA and the IBC Act fall short of the Principles in a number of respects. For example, there are inadequate provisions concerning the protection of minority shareholder interests, potential conflicts of directors' interests and there are no insider trading or abusive self-dealing provisions.

8.4.2.3 ***Foreign companies***

As indicated, foreign companies are companies incorporated outside the BVI which have a place of business in the BVI. These are not "offshore companies" and therefore do not fall within the scope of our review. We do consider, however, that it is important that the Registrar should have the ability to wind up such companies, to the extent that they have assets within the BVI.

8.4.3 **Audit**

8.4.3.1 ***Audit of accounts of public and publicly traded companies***

We consider that all public and publicly traded companies should, in line with OECD principles, be required to prepare and submit annual audited accounts.

In the case of both public and publicly traded companies these accounts should be available to the public. In the case of the BVI this is currently the case with public companies but not publicly traded IBCs.

Furthermore, their accounts should be prepared in accordance with International Accounting Standards or an equivalent (eg US GAAP). This will require an amendment to the CA.

8.4.3.2 ***Audit of accounts of private companies***

We do not consider that, unless it is a regulated institution, a private CA company or a private IBC should be required to prepare and submit audited accounts as the cost and burden of such a requirement would outweigh the benefits.

We consider that it is open to the shareholders in a private CA company or a private IBC to require the accounts of the company to be audited. We consider it appropriate that the choice should be the shareholders to make. Similarly it is a matter for potential creditors and others who do business with such companies to determine whether they wish to require an audit as a condition of entering into a business relationship.

8.4.4 **Directors**

We consider that a number of steps need to be taken to facilitate compliance with the OECD Principles in this area.

The OECD Principles require the responsibilities of directors to be adequately set out. In many common law jurisdictions this is covered by common law rather than statute.

Provision should be made in legislation for the disqualification of directors who are not fit to be involved in the management of a company. This will reduce the use of so called "nominee" directors as a director can be held accountable for a failure to fulfil his duties. The concept of "nominee" director is not recognised in the legislation and therefore it is important that effective action can be taken against those who do not exercise their fiduciary duties as directors appropriately. This approach accords with that taken in the "Review of Financial Regulation in the Crown Dependencies" (Section 11.1.4)

Whilst there is currently no requirement for an IBC to keep a register of directors or to file details of its directors with the Registrar, the BVI is proposing to introduce such a requirement. We support their view that every IBC should be required to keep a register of directors and file details of its directors with the Registrar. This approach is in accordance with the OECD Principles of Corporate Governance, Section IV, "disclosure and transparency".

We also consider that the names of directors should form part of the publicly available information held on the companies registry.

There is also a need to address the issue of corporate directors. We consider that the use of corporate directors, whilst common in both on and off-shore jurisdictions, could lead to a failure to comply with the OECD Principles concerning the responsibilities of the board and, in particular, the key functions of the board, such as reviewing and guiding corporate strategy.

It would, however, be inappropriate to impose a restriction on the use of corporate directors in the OTs until such time as the matter is addressed on a multi-jurisdictional basis. We, therefore, recommend that corporate directors should continue to be permitted until such time as the issue is addressed internationally. However, where corporate directors are provided by a company service provider, the CSP should be required to ensure that the directors' duties are being properly fulfilled. This is dealt with in the next section.

In summary, in respect of directors, we recommend that:

- an IBC should be required to file with the Registrar notice of the name and address of each director;
- those who provide directors by way of business should be required to take appropriate steps to ensure those directors are aware of their responsibilities and are suitable for the role; and
- provisions for the disqualification of directors on the grounds that they are not "fit to be involved in the management of a company" should be inserted into both the CA and the IBC Act.

8.4.5 **Beneficial ownership**

An effective way to determine beneficial ownership is through a requirement to formally disclose this to the Registrar. We recognise, however, that this approach is not always practicable. As an alternative we consider good practice is met by requiring company service providers to be licensed and to be obliged to establish and record the beneficial ownership of the companies for whom they provide the service. Our proposals in respect of this are contained in the section on company service providers.

The requirements for establishing beneficial ownership may be met by any client verification requirements which may be contained in the Money Laundering Code of Practice when issued. If so, there must be a link between the companies legislation and the Code of Practice so that the regulator can enforce the requirements directly. For example, a breach of the

Money Laundering Code of Practice could be a ground for disciplinary action including, where appropriate revocation of the licence. Recommendations in relation to this are covered in the section on CSPs.

8.4.6 **Bearer shares**

Bearer shares and share warrants to bearer can provide a significant level of anonymity, which may be abused by those seeking to use companies for a criminal purpose. Furthermore, fictitious bearer shares can be used to perpetrate fraud. There are, however, arguably legitimate reasons for the use of bearer shares and the issue of bearer shares or share warrants to bearer is permitted in many jurisdictions, including the United Kingdom.

In the circumstances, we do not consider that good practice requires the issue of bearer shares and share warrants to bearer to be prohibited but they must be controlled effectively to prevent abuse.

In our opinion, the issue, to an end client, of share warrants to bearer in respect of CA companies and bearer shares in an IBC is incompatible with good practice as the tracing of beneficial ownership may become impossible.

We, therefore, recommend that the CA and the IBC Act be amended to require the immobilisation of bearer shares as a condition of their issue. This should include measures whereby the beneficial owner can be identified by either the regulator or the registrar; that there are sufficient legal powers that this can be enforced so that regulators can obtain the information; and gateways so it can be passed (subject to suitable safeguards) to regulators in other jurisdictions.

8.4.7 **Registered office**

We consider that every CA company and IBC should be required to keep certain minimum information at its registered office. We consider that this should extend to the registers of members and directors.

In order that the audit trail is not broken we therefore recommend that every IBC should be required to keep at its registered office details of the location or locations where its books and records (including accounting records) are kept.

8.4.8 **Insolvency**

We consider that the winding up provisions in the CA are inadequate. This is obviously of concern as most CA companies will be trading in the BVI. In addition, however, the IBC Act does not contain any separate winding up provisions for insolvent IBCs, applying instead the winding up provisions in the CA.

Areas in which we consider that the insolvency provisions are inadequate include the following:

- There are no rescue procedures, such as the administration and company and individual voluntary arrangement provision, in the UK Insolvency Act 1986;
- There are inadequate provisions for the avoidance of pre-liquidation transactions, such as those made at an undervalue or which result in a preference of particular creditors;
- It is not possible for the liquidator to take action against directors who have caused the company to trade whilst insolvent (eg wrongful or fraudulent trading); and
- The cross-border insolvency provisions are inadequate.

Consequently, there are no adequate provisions in place for winding up either local trading CA companies or IBCs.

We, therefore, consider that the insolvency law generally in the BVI (including the winding up rules) needs to be reviewed and updated in line with modern standards and practice.

8.4.9 **Enforcement powers**

8.4.9.1 ***CA companies***

We recommend that the following additional enforcement powers should be created:

- the Registrar should have the power to strike a company off the Register if it fails to comply with an obligation imposed on it under the CA, eg to file its annual return;
- the Registrar should be able to apply to the Court for the winding up of a company on the public interest ground;

and

- it should be possible for the Registrar to initiate an investigation of the company by an inspector or, at least, make an application to the Court for such an investigation. The power of the inspector should include the ability to obtain all relevant documents and interview under oath.

8.4.9.2 ***IBCs***

We recommend that the following additional enforcement powers should be created:

- the Registrar should be able to apply to the Court for the winding up of an IBC on the public interest ground; and
- it should be possible for the Registrar to initiate an investigation of the company by an inspector or, at least, make application to the Court for such an investigation. The power of the inspector should include the ability to obtain all relevant documents and interview under oath.

8.4.10 **Other recommendations**

As previously indicated, non-routine correspondence between the registered agent of an IBC and the Registry is not placed on the company file but is filed on the registered agent's file. This may result in such correspondence, which may contain information which may subsequently be useful to the regulators or the police, being overlooked as it would not be apparent that the Registry holds further correspondence concerning the company.

We recommend that the company files are flagged, to put law enforcement agencies undertaking a search on notice, that there is also correspondence on the registered agent's file.

We welcome your comments on this site.

Prepared 27 October 2000

9 Company service providers

9.1 Introduction

Company management business typically encompasses a number of activities, including:

- the formation of companies for clients;
- the provision of the registered office for companies;
- the provision of the registered agent for companies (in those jurisdictions the legislation of which provides for registered agents);
- the provision of nominee shareholders;
- the provision of director services; and
- the preparation and filing of statutory forms for companies.

In this Report we refer to those who undertake company management business as company service providers ("CSPs").

There are no international standards concerning the regulation and supervision of CSPs, a point recognised by the Terms of Reference ("TOR"). Indeed, it is significant that few jurisdictions, either onshore or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of CSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide company services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed CSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the court to wind up a CSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a CSP's licence, as well as to pursue civil and criminal sanctions;
- CSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the directors of and the shareholders in a company serviced by a CSP and the beneficial owners of the shares in such a company; and
- CSPs, when providing director services, should be required to fulfil their responsibilities as directors and should not be permitted to abrogate their responsibilities through, for example, the use of general powers of attorney.

As indicated in the section on companies, the most practical and effective way of deterring the abuse of company structures and ensuring that relevant information is available to law enforcement authorities is through the regulation of CSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of CSPs in the BVI and our recommendations concerning enhancements are set out below.

9.2 Type and scale of activity

Company service provision in the BVI is undertaken by licensed CSPs and licensed trust companies.

The Company Management Act 1990 provides that no person, including an individual, may carry on the business of company management unless licensed under either that Act or the Banks and Trust Companies Act.

As at 31 March 2000 there were 16 licensed company managers. However, the FSD estimates that approximately 50 trust companies also carry on some form of company management business by virtue of their authorisation under the BTCA.

Section 39 of the IBC Act provides that the registered agent of every IBC must be a person licensed under the BTCA or the CMA. The Registrar of Companies is required to maintain a register of licensed agents under Section 40A of the IBC Act. As at 31 March 2000 there were 72 licensed registered agents which broadly corresponds with the licensed CSPs and trust companies referred to above.

Licensed company managers and trust companies between them provide registered agent services for approximately 250,000 IBCs.

9.3 **Factual assessment**

9.3.1 **Legislation**

The legislation relating to the regulation and supervision of CSPs in the BVI is as follows:

- the CMA, as amended by the Company Management (Amendment) Act, 1995;
- the BTCA; and
- the IBC Act (Sections 39 and 40A).

9.3.1.1 ***The CMA***

The CMA provides for the compulsory licensing of those engaged in company management business and for their on-going supervision by an Inspector of Company Managers ("Inspector") appointed under the CMA.

For the purposes of the CMA, company management means the business of:

- the registration of companies and IBCs;
- the provision of registered agent services for IBCs;
- the provision of registered office services for companies and IBCs; and
- the provision of directors, officers and nominee shareholders.

Persons may only undertake company management business if they are licensed under the CMA or the BTCA.

However, paragraph 6 of the Company Management Regulations, 1991 provides that a person whose company management business is restricted to:

(a) the provision of directors and officers; and

(b) the provision of nominee shareholders

is exempt from the requirement for a company management licence under the Act.

Areas covered by the CMA include:

- the granting, suspension and revocation of company management licences;
- the minimum capital requirement for licensee;
- the duties of licensee;
- the ongoing supervision of licensees;

- confidentiality and regulatory gateways; and
- insurance requirements.

The CMA places a number of requirements on licensed CSPs, including that:

- no share or other interest in a licensee may be transferred or disposed of and no director of a corporate licensee may be appointed without the prior written approval of the Governor in Council;
- a licensee must maintain separate accounts in his books (that is, accounting records) in respect of each company managed and segregate the funds and other property of each company from his own and must maintain one or more separate bank accounts into which he must deposit all monies held by himself on behalf of each company he manages; and
- a licensee must have his accounts audited on an annual basis.

The CMA permits the sharing of information with foreign regulatory authorities, including client information, provided the information is required to enable the foreign regulatory authority to discharge duties or exercise powers corresponding to those under the CMA or regulations made under the CMA and that the information will not be onward disclosed without the consent of the Governor in Council.

However, whilst the CMA provides the Inspector with powers to examine the books and records of a CMA licensee, he is not permitted to access client files without a Court order. The Inspector is therefore unlikely to have any client information in his possession which could be passed on to an overseas regulatory authority through the gateway.

The Inspector may require a licensee to effect insurance, for instance, in respect of negligence, dishonesty of employees and loss of documents. We understand from the FSD that although the Inspector has never requested a CMA licensee to effect an insurance policy and that no guidelines exist for determining the circumstances in which insurance will be required, most licence holders either have insurance in place or are in the course of effecting it.

9.3.1.2 ***The IBC Act***

As stated above, the IBC Act requires that a registered agent of an IBC must be a licensee under the CMA or the BTCA.

9.3.1.3 ***The BTCA***

Trust companies licensed under the BTCA are discussed in the section on trust service providers and the legislation in the section on banking. To the extent that trust service providers undertake company management activities, their regulatory requirements should be similar to those applicable to CSPs.

9.3.1.4 ***Proposed legislation***

A Bill for a Code of Conduct (Service Providers) Act ("Service Providers Bill") was drafted in 1998. The Bill envisages the establishment of a Council of Service Providers comprising representatives from the various sectors of the financial services industry. The primary role of the Council would be to provide the Government with policy advice. The Council would also have the power to prepare guidelines for use by service providers and to monitor compliance with the CMA by licensees.

The Bill also envisages the establishment of a separate body known as the "Disciplinary Committee" which would consider complaints made against service providers. If it found the complaint to be justified, the Committee would have the power to admonish the service provider, impose a fine on him, make a recommendation to the Government in relation to the service provider or make "such order as it considers fit in relation to the person".

The Bill has not been passed and will, to some extent, be superseded by the Anti-Money Laundering Code of Practice and the guidance notes once they are brought into effect (see the section on money laundering).

9.3.2 **Regulations, rules and guidance notes**

The only regulations in place relating to company management are the Company Management Regulations, 1991.

The Company Management Regulations contain certain prescribed forms.

There are no regulations in place governing the conduct of a CMA licensee. Consequently there is no requirement under the

CMA or BTCA for a licence holder to establish the beneficial ownership of the companies for whom he provides a service, (although they will be required to do so under the Anti-Money Laundering Code of Practice when it comes into force) nor are there any controls on the use or location of bearer shares. Similarly there are no obligations to ensure the competency of directors provided by company managers.

No guidance has been produced under the CMA.

The Anti-Money Laundering Guidance Notes, when brought into effect, will apply to CMA licensees. These are discussed in a later section of this report.

The Association of Registered Agents has produced a Code of Conduct for its members. This contains guidelines on "good practice". Membership of the Association of Registered Agents is not compulsory and, whilst the Code does provide sanctions and penalties for breaches of its terms, these are only enforceable against members of the Association. A number of registered agents are not members of the Association.

There are proposals for giving statutory effect to the Code of Conduct to make them enforceable against all CSPs. This is discussed further under "Issues and Recommendations" below.

9.3.3 **Supervision - systems and procedures**

9.3.3.1 ***Regulatory structure***

The Governor in Council is responsible for the licensing of CSPs under the CMA.

Day-to-day supervision of licence holders is undertaken by the Inspector. The Inspector is part of the FSD.

9.3.3.2 ***Licensing process***

Application for a CMA licence is made to the Governor in Council via the FSD in the form prescribed. An applicant for a licence is required to submit information on its shareholders, directors and managers, its authorised agent and evidence of appropriate company management experience. Character references are required for individual applicants, partners of partnership applicants and directors and officers in the case of corporate applicants. The Inspector reviews the application, makes such further enquiries and undertakes such checks as he considers appropriate and passes the application to the Governor in Council for approval or otherwise.

The CMA does not specifically require the applicant or its shareholders, directors or officers to be "fit and proper". However, such an assessment is made in practice.

Applicants are required to submit the following additional information with the application:

- a due diligence and compliance manual, which should include client acceptance procedures and "know your customer" policies;
- a three year business plan, which should include business objectives and financial projections;
- an undertaking to establish a physical presence in the BVI within a two year period from the date of issue of the licence; and
- details on the added value that the grant of the licence would provide to the economy of the BVI.

Before granting a licence, the Governor in Council must be satisfied that:

- the application is not against the public interest;
- the applicant is qualified to carry on the business of company management; and
- if the applicant is a company, it has a paid up share capital of at least US $25,000.

Current government policy is to grant company management licences only to entities with a real physical presence in the BVI. We have been advised by the FSD that CMA licences are usually only granted to:

- nationals wishing to establish a foot-hold in the industry;

- foreign-based entities who will either provide services not currently being provided in the BVI; or
- foreign-based "blue chip" entities whose presence in the BVI is considered by the FSD to improve the BVI's status as an international financial services centre.

Where a foreign-based entity is granted a CMA licence, we understand that it is required by the FSD to establish a separate office and to apply for a general trust licence within two years of the granting of the licence.

9.3.3.3 ***Ongoing supervision***

Off-site

Every company manager is required to provide the Inspector on an annual basis with:

(a) audited financial accounts; and

(b) a certificate of compliance, issued by an independent auditor, that the information set out in the application for a licence, as modified by a notification of change, remains correct and gives an accurate summary of the business of the licensee.

The accounts are reviewed by the Inspector. There are no other requirements to provide information on an ongoing basis.

On-site

The Inspector has power to conduct on-site inspections but he is not able to review individual client files unless he has the client's permission or a Court order.

The Inspector has very recently commenced an on-site inspection programme in respect of company managers.

9.3.4 **Enforcement - systems and procedures**

The main powers of enforcement available under CMA are as follows:

- the Governor in Council may require a licensee to change the name under which he carries on company management business (section 15(2));
- the Inspector may, at any time, require a licensee to produce an independent auditor's certificate of compliance and evidence of his solvency and, in the case of a company, evidence that its paid up share capital has been maintained;
- the Inspector may apply to the Court for a search warrant where the licence of a licensee has been suspended or there are reasonable grounds for suspecting that an offence under the CMA has been committed;
- the Governor in Council may suspend a licence for up to 30 days where he is satisfied that the licensee is carrying on business in a manner detrimental to the public interest, or the interests of companies being managed by him, or in contravention of any other law; and
- the Governor in Council may revoke a licence if the licensee ceases to carry on company management business, becomes insolvent or if the Inspector, following an inspection, reports to the Governor in Council that in his opinion it would be detrimental to the public interest for the licensee to carry on company management business.

There is no power for the Inspector to apply to the courts for the winding up of a licence holder in the public interest.

9.4 **Issues and recommendations**

9.4.1 **Introduction**

The BVI has in place a number of regulatory provisions relating to the supervision of those engaged in company service provision. We consider this to be a positive feature of the BVI's regulatory structure and one that exists only in a limited number of other jurisdictions.

At present the depth of regulation is limited and additional features are required to bring the BVI fully in line with the Guidance Notes. These are detailed below.

We are pleased to note that many of these deficiencies have already been identified by the FSD and efforts are being made to

rectify them.

As stated, BTCA licensees are exempted from the CMA. Given the policy of the FSD, most of the company management business in the BVI is carried on by licensees under the BTCA. The regulation of BTCA licensees is covered in the sections of this report on banking and trust service providers.

Although we have not considered the BTCA in this section, we consider that it is essential that, in respect of their company management activities, the regulatory regime to which BTCA licensees are subject (under the BTCA) provide at least equivalence to the regulatory regime to which a licensee under the CMA is subject.

9.4.2 **Scope of the legislation**

We cannot see a justification for the exemption granted by the Company Management Regulations to those who only provide directors and officers and nominee shareholders for companies.

We consider that, as a result of the exemption, there is a gap in the regulation of CSPs, particularly as the provision of directors is an important company management function.

Therefore, we recommend that the exemption provisions in the Regulations should be revoked as a matter of priority. All CSPs should be regulated, either under the CMA or the BTCA.

9.4.3 **Regulatory supervision**

9.4.3.1 ***International co-operation***

We consider the current gateways for co-operating with foreign regulatory authorities are generally good and permit the sharing of client information. However, this will not be effective unless the Inspector has access to client information. As the CMA does not currently permit the Inspector to obtain client information without the client's permission or a Court Order, we do not consider that the good practice standards set out in the Guidance Notes are being met.

Therefore, we recommend that the CMA be amended to allow the Inspector access to client information in specific circumstances.

9.4.3.2 ***Licensing process***

We consider that the CMA currently makes insufficient provision with regard to the application process. The only conditions which the CMA requires an applicant to meet are that the applicant is qualified to carry on company management business, that the application is not against the public interest and that, in the case of a company, its paid up share capital is at least US$25,000.

We note, for example, that there is no requirement for the applicant, its shareholders, beneficial owners, directors and managers to meet the "fit and proper" criteria. The term "qualified" is, on its own, too general.

Whilst we are advised that the Inspector is applying fit and proper criteria, in our view the legislation should be amended to formally reflect this practice.

Although we do not consider that "four eyes" control should be an automatic requirement for every CSP, we consider that in the majority of cases it will be appropriate. Therefore, we recommend that as part of the review process for an application, the Inspector should consider whether the business proposed to be undertaken by the applicant justifies the imposition of a requirement that at least two people will be involved in the operation of the CSP to provide support and oversight. Where a licence is granted to a CSP without requiring "four eyes" control, the Inspector should keep the situation under review as it may subsequently become appropriate for him to impose such a requirement.

9.4.4 **Code of Practice**

To facilitate the meeting of the international and good practice standards identified in the Guidance Notes, we consider that all CSPs should be subject to an enforceable Code of Practice. The Code of Practice should include requirements relating to:

- the maintenance of the records in the jurisdiction;
- knowing the beneficial owner of a company on an ongoing basis;

- the suitability of directors provided by the licence holder;
- the mechanisms for ensuring the immobility of bearer shares;
- the provision of powers of attorney;
- the conduct of directors provided by licence holders;
- the segregation of client money and assets; and
- the provision of signing authorities to other persons, including shareholders and the beneficial owners of shares, to a bank account of a company where the licence holder provides director services.

The anti-money laundering regulations, when issued, should apply to CSPs. To the extent that the anti-money laundering regulations, cover matters listed above, the Code may simply make adherence to those regulations, and any guidelines issued under them, a requirement under the Code of Practice so providing enforcement powers for the regulator even if no criminal action is taken as a result of the breach.

We consider that the Code of Practice should replace the Code of Conduct produced by the Association of Registered Agents.

Given the size and importance of the company sector to the BVI, we recommend that the introduction of an enforceable code be recognised as a priority.

9.4.4.1 ***Ongoing supervision***

Off-site

We consider that the off-site review process should be enhanced. All CMA licensees should be required to file regular compliance returns providing details of their activities and confirming adherence to the Code of Practice.

On-site

Although the Inspector has commenced an on-site inspection programme in respect of CMA licensees, we do not consider that it is fully effective for the reasons set out below.

At the time of our visit there were just two officers responsible for the supervision of all licensed banks, trust companies and company managers. Given the volume of work involved, it would be quite impossible for those officers to undertake a proper on-site inspection programme of CMA licensees.

As indicated, the CMA restricts the access of the Inspector to client files or information, unless he has the written consent of the company concerned or an order of the Court made on the grounds that there are no other reasonable means of obtaining the information.

We do not consider that the Inspector can carry out an effective on-site inspection without access to client files to test the processes and procedures of the licensee and to ensure that the CMA and the Code of Practice (when issued) is being complied with.

We consider that there is a need for legislative authority to enable the Inspector to undertake on-site inspection visits and to give him the ability to review individual client files to ensure that the CMA and code of practice is being complied with.

We, therefore, recommend that the CMA should be amended to give the Inspector routine access to client files for the purposes of an on-site examination.

We also note that no on-site procedures manual exists. We recommend that an on-site procedures manual is developed.

The issue of staff resources is covered in the regulatory section of this report.

9.4.5 **Enforcement**

We consider that there are a number of valuable enforcement powers within the CMA.

To ensure that the Inspector has the fullest range of enforcement powers possible, we consider that, in addition to his current

powers, he should have the ability to:

- apply to the Court, where necessary, for injunctive or other reliefs to protect the clients of a licensed or formerly licensed CSP;
- petition the Court for the winding up of a licence holder or a former licence holder in the public interest; and
- "police the perimeter" by conducting investigations of persons suspected of undertaking licensable activities without authorisation.

This will enable the Inspector to both detect and deter abuse and take appropriate action where it is discovered.

9.4.6 **Insurance**

As noted, no CMA licensees have been required to effect insurance cover in respect of their company management business and no guidelines have been issued specifying when CMA licensees should be requested to effect insurance cover and the types of cover required.

We accept that the cost of professional indemnity and other insurances is high and may be an unnecessary burden in some cases. Nevertheless, we consider that there is a strong argument for requiring every CSP to effect professional indemnity insurance cover and for requiring any CSP who has control over client funds to effect fidelity insurance.

However, without a greater knowledge of the business undertaken by CSPs in the BVI, we do not consider that it would be appropriate for us to make specific recommendations as to the circumstances in which CSPs should be required to effect insurance cover nor as to the types and minimum amounts of such cover.

We recommend that the Inspector should, perhaps after taking specialist insurance advice, prepare guidelines setting out in detail the circumstances in which licensed CSPs are required to effect insurance, the type of insurance to be effected and the minimum amounts of cover required. We consider that it is appropriate for the Inspector, in preparing these guidelines, to assess whether the cost of insurance is proportional to the benefits in client protection that it would bring.

Finally, a licensee who is required to effect insurance cover should be required to satisfy the Inspector that the appropriate policies are in place on an annual basis.

9.4.7 **Bearer shares**

The BVI have recognised that the issue of bearer shares to end clients without any control being exercised is contrary to good practice as it is difficult, if not impossible, to ascertain the beneficial owner of the company at any given time. Therefore, they are considering action to reduce this problem.

We are advised by the FSD that most CSPs in the BVI do not issue bearer shares, where they provide fiduciary services, unless they are able to retain control over the bearer shares.

However, as has been pointed out to us, where an IBC is incorporated and the company manager does not provide director services, the directors can issue bearer shares without the knowledge of the company manager.

Whilst we are not persuaded that international practice and standards require the outright prohibition of bearer shares, we consider that their use must be strictly controlled. The appropriate method of achieving this is to regulate their issue by amendment to the IBC Act. We, therefore, consider that the IBC Act should be modified to require that bearer shares may only be issued if they are immobilised. This is dealt with in the section on companies.

The immobilised bearer share must either be retained by a licensed CSP or by someone acting on his authority. The details of the requirement should be contained in the Code of Practice.

If this cannot be achieved, consideration should be given to prohibiting the use of bearer shares.

9.4.8 **Bill for a Code of Conduct (Service Providers) Act**

As discussed, the Service Providers Bill envisages the establishment of a self-regulatory system for CSPs. We do not consider that this represents the most effective or practical way of dealing with this issue. The regime established would require regulatory supervision by the FSD and, as the FSD currently regulates CSPs, it would be more logical if the requirements formed part of a regulatory structure. We consider that an enforceable Code of Practice is preferable.

Furthermore, the Council would be responsible for monitoring compliance by CSPs but it is not clear how this would be achieved as the Council would not be given powers to undertake inspections of service providers or even to summon service providers before it. The Disciplinary Committee has no locus unless a complaint is made.

We, therefore, recommend that the Service Providers Bill be dropped in favour of the approach to regulation outlined above, with the imposition of an enforceable Code of Conduct.

We welcome your comments on this site.

Prepared 27 October 2000

10 Partnerships

10.1 Introduction

The legislation in all of the OTs provides for two different types of partnership, ordinary or general partnerships and limited partnerships. None of the OTs have legislation in place that provides for the formation of limited liability partnerships (ie partnerships which are separate legal entities where, unlike limited partnerships, the limited partners are permitted to take part in the management of the business and which are primarily used as vehicles for professional firms).

10.1.1.1 *Ordinary partnerships*

The ordinary partnership legislation of those OTs that have it is based upon the UK Partnership Act. Neither the UK Partnership Act nor the OT partnership legislation establishes supervisory regimes. The legislation typically sets out the rules for determining the existence of a partnership and governs, to a limited extent, the relationship between partners and between the partnership and third parties. Ordinary partnerships are not subject to registration in any of the OTs. The liability of all partners in an ordinary partnership is unlimited.

Ordinary partnerships are formed almost exclusively by domestic businesses in the OTs usually where the business is small or where the members of a particular profession are prohibited from carrying on business through a limited liability company.

As ordinary partnerships are not generally used for offshore purposes we do not consider that they fall within our TOR and we have not covered them in our review. In so far as ordinary partnership, such as lawyers and accountants, also act as company or trust service providers their role is dealt with in those sections of this Report.

10.1.2 Limited partnerships

Limited partnerships enable the liabilities of "sleeping partners" to be limited to their capital contribution provided that they do not take part in the management of the partnership. They are used typically in investment schemes to limit the liability of investors without giving them ownership of a share in a company. They are also used in estate planning schemes.

The TOR and the Guidance Notes require us to determine whether the legislation, framework and systems in place in each OT conform to good practice having regard, in particular, to FATF and CFATF Recommendations, the OECD Principles of Corporate Governance ("the OECD Principles") and the G22 Report on Transparency and Accountability.

There are no international standards that relate specifically to the supervision of limited partnerships. We have, therefore, considered the appropriateness of the above general standards for limited partnerships. It is our view that:

- the FATF and CFATF Recommendations that are of primary relevance to limited partnerships are those that concern "know your customer" and record keeping procedures;
- the OECD Principles are designed primarily for publicly traded corporations and are not appropriate to limited partnerships; and
- the G22 Report on Transparency and Accountability is not applicable to limited partnerships.

Due to the limited liability given to limited partners, limited partnerships are attractive offshore vehicles and, in common with all offshore vehicles, are subject to potential abuse by money launderers and other criminals. We therefore consider that good practice requires that, in the event that a limited partnership is suspected of being involved in criminal activity, the law enforcement authorities should be able to access information concerning both the limited and general partners. This approach was envisaged by the Guidance Notes.

We also consider that the business of:

- forming limited partnerships;

- providing a registered office for limited partnerships; and
- acting as a registered agent

should be regarded as financial services. As such, it is important that high standards are maintained for the protection of clients. Subject to special circumstances, we consider that good practice standards require that these activities should be regulated.

10.2 **Type and scale of activity**

There are two types of partnership provided for in the BVI, general partnerships and limited partnerships. Limited partnership may be local limited partnerships or international limited partnerships.

As at 25th April 2000 the following limited partnerships were registered in the BVI:

- international limited partnerships - 70;
- local limited partnerships - 0.

No statistics are kept on the type of business carried on by limited partnerships in the BVI. The objects and purposes of the partnership are usually expressed in very general terms in the memorandum and any statistics compiled would therefore not be of much value.

10.3 **Factual assessment**

10.3.1 **Legislation**

The BVI has one piece of legislation concerning partnerships, the Partnership Act, 1996 ("PA"). The PA covers both general partnerships and limited partnerships.

General partnerships are covered by Parts I to V of the PA.

Part VI of the PA provides for the formation and registration by the Registrar of Limited Partnerships ("the Registrar") of limited partnerships. Limited partnerships consist of one or more general partners and one or more limited partners.

The provisions are similar to the limited partnership legislation found in the US State of Delaware. Except as provided in Part VI, the provisions of Parts I to V also apply to limited partnerships. As indicated, a limited partnership is either a local limited partnership or an international limited partnership.

The general partners carry on the business of a limited partnership and have the same liabilities and responsibilities as partners in a general partnership. Limited partners contribute or undertake to contribute capital to the partnership and their liability is limited to the capital that they have contributed or undertaken to contribute.

To the extent that a limited partner participates in the control of a limited partnership, he is liable as a general partner to persons who transact business with the limited partnership reasonably believing that he is a general partner.

No limited partnership may carry on banking, trust, or insurance business. A limited partnership may, however, carry on company management business if licensed under, or exempted from, the Company Management Act, 1990. A limited partnership may also be registered under the Mutual Funds Act, 1997.

An international limited partnership may not carry on business with persons resident in the BVI or, subject to a minor exception, own any real property in the BVI, although the PA does not specify the consequences of a breach of this provision.

A limited partnership must have a registered office and a registered agent in the BVI.

Part VII contains certain miscellaneous provisions including, in Section 110, the application of the continuation provisions of the IBC Act to limited partnerships.

10.3.2 **Regulations, rules and guidance notes**

There are no rules, regulations or guidance notes in place concerning partnerships.

10.3.3 **The formation and registration of limited partnerships**

Limited partnerships must be registered with the Registrar. Registration is effected by filing with the Registrar a memorandum signed by or on behalf of the registered agent containing basic information concerning the partnership and its partners.

Subject to a minor exception, the registered agent of a limited partnership must be a licence holder under the CMA or the BTCA. The exception relates to a local limited partnership, the general partner of which may be its registered agent.

Persons who carry on the business of forming limited partnerships or providing the registered office for limited partnerships are not, in that capacity, currently regulated.

Nor are they covered by the Anti-Money Laundering Code of Practice to be brought into force. However, persons who carry on business as general or limited partners are subject to the Code.

10.3.4 **Supervision - systems and procedures**

10.3.4.1 ***Regulatory structure***

The functions of the Registrar are carried out by the Registrar of Companies. Details of the structure and resources of the Registrar and Companies Registry are provided in the section of this Report on Companies.

10.3.4.2 ***On-going supervision***

In common with other jurisdictions, there is no on-going supervision of limited partnerships.

10.3.5 **Enforcement - systems and procedures**

The following enforcement procedures are available in respect of limited partnerships:

- where the registered agent of a limited partnership ceases to act as registered agent or is no longer licensed under the CMA or the BTCA, the limited partnership will be struck off the register if it does not appoint a new registered agent;
- the Minister may, on the application of a limited partnership or a minimum proportion in value of the limited partners, appoint an inspector;
- where an inspector is appointed, the Minister may, in the prescribed circumstances, on receipt of the report apply to the Court for the dissolution of the limited partnership or require it to take measures that he may specify; and
- where he considers there is good reason, the Minister may require a limited partnership, its registered agent or a partner, to produce books and documents and in default of compliance apply to the Magistrate for a search warrant.

A breach of the PA also constitutes an offence and is punishable by a fine.

10.3.6 **Publicly available information**

10.3.6.1 ***Information held by the Registrar***

The information contained in the register of limited partnerships maintained by the Registrar covers the following:

- the objects and purposes for which the partnership is established;
- the address of the registered office of the limited partnership in the BVI;
- the name and address of the registered agent of the limited partnership in the BVI;
- the names and addresses of the general partners; and
- the term, if any, of the limited partnership.

A limited partnership is required to inform the Registrar of changes in any of the above details.

The register of limited partnerships, in which each memorandum is registered, is open to public inspection.

10.3.7 **Non-public information**

The general partners of a limited partnership must keep a register containing the name and address and the amount and dates of contributions of each partner and the amount and date of any payment representing a return of any part of a partner's contribution at the registered office.

A limited partnership is also required to keep such accounts and records as the partners consider necessary or desirable in order to reflect the financial position of the partnership.

These accounts and records are not required to be kept at the registered office or in the BVI.

The above information is not available to the public.

10.4 **Issues and recommendations**

10.4.1 **Introduction**

In accordance with our interpretation of our TOR, we are required to assess whether:

- in the event that a limited partnership is used or suspected of being used for criminal purposes, the law enforcement authorities in the BVI are able to obtain basic information concerning the partnership, such as the identity of the partners;
- the true identity of general and limited partners of limited partnerships in the BVI has been ascertained through the usual "know your customer" procedures; and
- adequate procedures are in place to protect the interests of partnerships utilising professional service providers in the BVI.

For the reasons set out in the following paragraphs we are of the view that, with some minor exceptions, the legislation and systems in place in the BVI concerning limited partnerships meet, and in some respects exceed, good practice standards.

We also consider that some further enhancements may be desirable and these are set out below.

10.4.1.1 ***Availability of information to law enforcement agencies***

The information required to be filed with the Registrar is set out in paragraph 10.3.6.1. This includes basic information, but it does not include details of the limited partners and their capital contributions.

The information filed is available to the public and, therefore, readily accessible to the law enforcement authorities in the BVI.

We do not consider that good practice requires that information concerning the limited partners and their capital contributions should be filed at the Registry provided that the information is available in the BVI.

The PA currently requires the general partners to keep a register of limited partnership interests containing the above information. This information is not available for public inspection but, subject to Court Order, they could be accessed by the law enforcement agencies if required.

We are, therefore, of the opinion that the legislative requirements prescribing the information and records to be kept in the BVI meet good practice standards. Of course the quality of the information will be dependent upon:

- the due diligence checks undertaken with regard to partners; and
- the degree of compliance with regard to the other record keeping requirements.

10.4.1.2 ***Application of know your customer and record keeping requirements***

In order to comply with FATF and CFATF Recommendations, we consider that persons who provide the service of forming limited partnerships for profit and those who provide registered office or registered agent services for limited partnerships should be subject to the usual know your customer and record keeping requirements.

Subject to a minor exception already referred to, only licensees under the CMA or the BTCA may provide registered agent services. They will, therefore, be subject to the draft Anti-Money Laundering Code in that capacity. It will, however, be necessary to ensure that their obligations under the regulations apply to their activities as partnership service providers as well.

We, therefore, recommend that the Anti-Money Laundering Code be amended to cover any person who, as part of their business:

- forms limited partnerships; and
- provides the registered office of limited partnerships.

We note that under the current draft, none of the above will be subject to the Code of Practice, although persons carrying on business as general or limited partners will be covered.

We consider that it would be appropriate to remove the reference to general and limited partners and substitute a reference to persons forming limited partnerships or acting as the registered agent for limited partnerships.

For the reasons set out below we consider that the registered office of a limited partnership should be provided by its registered agent. If this recommendation is accepted, there will be no need to specifically cover persons providing registered office services.

10.4.2 **Regulation of professional service providers**

We are of the opinion that persons who, for profit, form limited partnerships or provide registered agent and registered office services for limited partnerships should be considered as financial service providers and subject to regulation. The objectives of regulation are as follows:

- the maintenance of standards generally that will protect partnerships using the service providers; and
- the maintenance of high record keeping standards so that records required to be kept at the registered office are maintained in good form so that they are of value to the law enforcement agencies, if required.

In respect of registered agents the BVI already meets those standards. As indicated, there is an exception where the general partner of a local limited partnership is its registered agent. We consider that this exception is reasonable provided that the general partner in such a situation is subject to the Anti-Money Laundering Code of Practice.

Section 82 of the PA provides that the registered office of a limited partnership must be maintained by the limited partnership or its registered agent. We consider that in respect of international limited partnerships at the very least, the registered office should be maintained by the registered agent. Where the limited partnership maintains its own registered office, the general partner should be made subject to the Anti-Money Laundering Code of Practice.

We consider that the LPO should be further amended to provide that only licensees under the CMA or the BTCA are permitted to form limited partnerships for profit.

10.4.2.1 ***Other areas for improvement***

The enforcement powers, which are listed above, are extensive and, in our view, exceed good practice standards. However, we consider that the powers could be enhanced by empowering the regulator, in suitable circumstances (for example, on the public interest ground), to apply to the Court for the appointment of an Inspector or dissolution of a limited partnership.

We also consider that it should be an offence to act as the registered agent of a limited partnership when not holding a licence under the CMA or the BTCA.

Finally, we note that Part VII contains certain miscellaneous provisions including, in Section 110, the application of the continuation provisions of the IBC Act to limited partnerships. Given that a limited partnership is not a body corporate, we are unclear as to how this works.

We note that the PA requires minimum accounting records to be kept. These are not required to be kept at the registered office of the limited partnership. In order that the audit trail is not broken, we recommend that where the records are not kept at the registered office, the limited partnership should be required to maintain at the registered office a written record of the location or locations where they are kept.

We welcome your comments on this site.

Prepared 27 October 2000

11 Trusts

11.1 Introduction

Trusts are commonly used in offshore structures. They typically involve settlors, trustees and beneficiaries and often involve protectors, enforcers and custodians.

The settlor of a trust[2] is the person who transfers ownership of his 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.

The trustees of a trust hold legal title to the trust property. They must keep trust property separate from their own property. 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 invite and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes.

All trusts (other than purpose trusts) must have beneficiaries who may include the settlor. The trustees must account to the beneficiaries for what they do with the trust property. The beneficiaries are entitled to enforce implementation of the trust deed. A trust may be settled without existing beneficiaries provided that a beneficiary is or beneficiaries are ultimately ascertainable.

A trust may have a protector who will typically have powers to veto the trustees' proposals or remove them. A purpose trust is a trust for a particular purpose or purposes. Most of the OTs permit charitable and non-charitable purpose trusts.

An enforcer is the person who has the power to enforce a purpose trust.

A custodian trustee holds the trust property to the order of the managing trustee.

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the Terms of Reference ("TOR"). The TOR, therefore, require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries and protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary, because a proper consideration of the above issues involve both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the "Review of Financial Regulation in the Crown Dependencies" (Section 12.9.5). Our recommendations concerning professional trust providers in

the BVI are contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of the BVI are required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not in this Report concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

11.2 Type and scale of activity

There are no requirements for trusts to be registered or reported in the BVI. There are consequently no statistics available on the type and scale of activity of the trust business in the BVI. It is not, therefore, possible to provide an estimate of the number or the net value of trusts administered in the BVI.

We have been informed by FSD and by representatives of the private sector, however, that most of the trust business administered in the BVI is private rather than commercial.

There is no legislation that specifically provides for asset or creditor protection trusts which, in consequence, do not form a significant part of the trust business undertaken in the BVI.

Purpose trusts, both charitable and non-charitable, are permitted although the extent to which they are used is unclear.

11.3 Factual assessment

11.3.1 Legislation

The principal legislation relating to trusts in the BVI is the Trustee Act ("TA").

The TA makes general provision for trusts in the BVI and provides for the duties and powers of trustees. The Act is based on the English Trustee Act 1925, although there are differences.

The TA includes a provision that no assent of the law of the settlor's domicile relating to inheritance or succession shall affect the validity of a trust. The Act, therefore, permits the creation of "forced heirship" trusts which are commonly utilised by settlors from jurisdictions where the law requires assets in a deceased's estate to be distributed in accordance with a particular formula. By settling his assets into a forced heirship trust, a settlor attempts to leave his assets according to his or her wishes rather than in accordance with the formula stipulated by the law of his jurisdiction.

A number of other jurisdictions have similar legislation facilitating the creation of forced heirship trusts.

The TA also permits non-charitable purpose trusts. At least one of the trustees of a non-charitable purpose trust must be a designated person, that is, a BVI lawyer, an accountant qualified under the BTCA to be an auditor, a licensee under the BTCA or a person designated by the Minister.

A non-charitable purpose trust must have an enforcer appointed to enforce the trust.

Where a trustee who is a designated person becomes aware that there is no enforcer or no enforcer acting he must inform the Attorney-General who must apply to the Court for the appointment of another person to enforce the trust.

11.3.2 Regulations, rules and guidance notes

There are no regulations, rules or guidance notes with respect to trusts.

11.3.3 Supervision and enforcement - systems and procedures

Trusts are not registrable in the BVI and, in common with other jurisdictions, are not subject to regulation by a regulatory authority. There is, therefore, no requirement for trustees, beneficiaries, custodians or protectors of BVI trusts to be notified to any central authority.

Trustees do, however, have a number of duties imposed on them under the TA and the duties imposed on a trustee under English common law would almost certainly be imposed on trustees by the courts in the BVI.

11.4 Issues and recommendations

11.4.1 **Introduction**

Trust legislation in the BVI is similar to the trust legislation in a number of other jurisdictions, including England. In general, we do not consider that there are any particular features of the TA that are likely to lead to trust structures in the BVI being any more or less attractive to criminals or money launderers than trusts in other jurisdictions.

11.4.2 **Preventing the abuse of trusts**

As indicated in the Introduction to this section, we consider that the most practical and effective way to prevent the abuse of trusts is through the regulation of trust service providers. We consider that all persons providing trust services should be regulated. Our recommendations concerning this are set out in the next section. We do not consider that any changes to the TA are required to support this.

We are concerned, however, that the use of purpose trusts may be open to abuse. Purpose trusts have no beneficiaries to take action against trustees who are in breach of their duties and there is therefore a possibility of abuse by the trustees.

We note that under the TA, however:

- all non-charitable purpose trusts must have an enforcer; and
- at least one of the trustees of a non-charitable purpose trust must be a designated person (that is, a professional).

We consider that the protections contained in the TA meet good practice standards, however, we recommend that a requirement to keep essential trust records in the BVI is imposed on the designated person.

11.4.3 **Establishing the true owner of trust assets**

In general, beneficial ownership of assets held in an express trust may be clear and ascertainable. However, this may not necessarily be the case for a discretionary or purpose trust or where the trustees may exercise discretionary powers.

We consider that, in the case of trusts administered by a professional trust service provider, law enforcement and regulatory authorities must, in appropriate circumstances, be able to identify the settlor, trustees, beneficiaries, protector and custodian and have access to the trust instrument and other relevant documentation concerning the trust.

This requires that the relevant documentation and information is kept within the jurisdiction. In respect of trust service providers, this is covered in the next section. This is not a general trust issue and we do not, therefore, consider that the TA requires any amendment in this respect.

11.4.4 **Anti-money laundering systems**

In our opinion, international standards require that professional trust service providers should be required to put in place effective anti-money laundering measures, including know your customer, record keeping and staff training procedures.

Our recommendations concerning this are in the sections on money laundering and trust service providers.

We do not consider that it is appropriate to deal with this matter in the TA as the TA is not supervisory in nature.

11.4.5 **Transparency of financial arrangements**

The Guidance Notes indicate:

- that basic financial information relevant to the activities of trusts should be available to law enforcement and regulatory authorities; and
- that trustees should, ideally, be held accountable to beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector, where applicable.

We are further asked to consider in what circumstances it would be appropriate for accounts to be produced, whether accounts should be made public, in which circumstances abbreviated accounts might be acceptable and in which circumstances the requirement to produce accounts should not be applied.

We consider that professional trust service providers should be required to maintain proper financial records and that these should be available for inspection by the protector and beneficiaries. We also consider that these records should be available

to law enforcement authorities where required in a criminal investigation. Our recommendations concerning this are contained in the next section of this Report.

However, we consider that requiring the preparation of accounts and their subsequent audit may be regarded by some clients as an unnecessary cost burden. In our view it should be for the client to determine whether he wishes accounts to be prepared and audited. It is not the role of legislation to impose it. Nevertheless we believe that the preparation and where appropriate, auditing of trust accounts, is of benefit as it reduces the risk of misappropriation of trust assets.

11.4.6 **Removal of impediments to asset tracing and seizure**

This is considered further in the section on money laundering.

There is nothing in the legislation to prevent a "flee" clause being included in a trust deed, the effect of which may be to frustrate the seizure of assets emanating from a criminal source.

We, therefore, recommend that as flee clauses are an issue of general application, trust legislation should be amended to restrict their use.

11.4.7 **Asset or creditor protection trusts**

As indicated, the BVI does not have legislation providing for asset or creditor protection trusts.

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2 The descriptions of settlors, trustees, beneficiaries, protectors, enforcers and custodians are based on those set out in the "Review of Financial Regulation in the Crown Dependencies" which we consider provide excellent summaries. Back

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We welcome your comments on this site.

Prepared 27 October 2000

12 Trust service providers

12.1 Introduction

There are no international standards concerning the regulation and supervision of trust service providers ("TSPs"), a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either on or offshore regulate these activities. The TOR, therefore, require us to assess whether the legislation, framework and arrangements in place for the regulation of TSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide trust services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed TSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the Court to wind up a TSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a TSP's licence, as well as to pursue civil and criminal sanctions;
- TSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the settlor, beneficiaries, protector and the custodian (where applicable) of a trust and to obtain a copy of the trust instrument;
- law enforcement and regulatory authorities should be able to access financial information relevant to the activities of trusts administered by a TSP; and
- trustees should be held accountable to the beneficiaries and settlor, and the protector, where applicable, by preparing regular accounts, where appropriate.

As indicated in the section on trusts, the most practical and effective way of deterring the abuse of trusts and ensuring that relevant information is available to law enforcement authorities is through the regulation of TSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of TSPs in the BVI and our recommendations concerning enhancements is set out below.

12.2 Type and scale of activity

Every company that carries on trust business from within the BVI must be licensed under the Banks and Trust Companies Act, 1990 ("BTCA"). As at 31 March 2000, there were 192 licensed trust companies of which 84 held a general trust licence and 108 held a restricted trust licence.

The Financial Services Department ("FSD") advises that the majority of licensed trust companies are multi-jurisdictional trust companies with offices in the BVI.

The definition of Trust business under the BTCA includes company management. As a result many trust companies with full trust licences do not carry on any trust business but actually carry on company management business only. Indeed the licence may contain the restriction on the licence holder to carry on company or trust management only.

12.3 Factual assessment

12.3.1 Legislation

The legislation governing the regulation of trust business is the BTCA, which was amended in 1995.

The BTCA covers both banking and trust companies. In this section we are concerned with only those provisions of the BTCA that relate to trust companies.

The legislation provides for the licensing of companies that carry on trust business, which is defined in Section 2 as the business of:

- acting as a professional trustee, protector or administrator of a trust or settlement;
- managing or administering any trust or settlement; and
- company management as defined by the Company Management Act, 1990.

Subject to Section 6(2), every company carrying on trust business must be licensed under the BTCA. Section 6(2) of the BTCA provides that the BTCA does not apply to a person licensed under the Company Management Act, 1990.

Whilst this exemption creates a potential significant regulatory loophole the Inspector of Bank and Trust Companies believes this is resolved by the use of conditions restricting activities that can be undertaken by a licence holder.

Individuals and partnerships carrying on trust business are not required to be licensed under the BTCA and are not regulated under any other Act.

The Banks and Trust Company Regulations, 1991 also provide that a person who undertakes no business other than:

(a) the provision of directors and officers; and

(b) the provision of nominee shareholders;

for companies is exempt from the requirement for a trust licence under the Act. This mirrors the exemption in respect of company management business contained in the Company Management Regulations, 1991 and is an extremely wide exemption.

Trust licences are either general or restricted. A general trust licence enables a trust company to carry on trust business without any restrictions. A trust company holding a restricted trust licence must not undertake trust business for persons other than those listed in any undertaking accompanying the application for the licence.

Upon granting a general trust licence to a company, the Governor in Council may include in the licence one or more subsidiaries of the company, authorising them to carry on the type of trust business specified in the application.

Areas covered by the BTCA include:

- granting, surrender and revocation of trust company licences;
- minimum capital requirement for licensee;
- control of changes in ownership of shares in a trust company;
- control of appointment of directors;
- appointment of an Inspector of Banks and Trust Companies;
- duties of licensee;
- ongoing supervision of licensees;
- enforcement powers; and
- confidentiality and regulatory gateways.

Section 24(1) of the BTCA provides that any information disclosed to the Inspector of Bank and Trust Companies or the Director of Financial Services or any person exercising under their authority a power under the BTCA is absolutely privileged and must not be disclosed except as provided in Section 24(2). Section 24(2) provides, *inter alia*, that the

restriction does not apply to disclosures made in the following circumstances:

- to the Governor in Council, Minister of Finance or a public officer approved by the Minister of Finance;
- to a person for the purpose of discharging any duty or exercising any function under the BTCA or regulations made under it;
- on the order of a Court of competent jurisdiction for the purpose of any criminal or civil proceedings;
- for the purposes of legal assistance in the investigation of criminal matters on request from a "high ranking officer" in a recognised international organisation or in a law enforcement agency in a jurisdiction approved by the Governor in Council; and
- for the purpose of enabling or assisting a foreign regulatory authority in a country or jurisdiction approved by the Governor in Council in discharging duties or exercising powers corresponding to those under the BTCA or regulations made under it.

In respect of the last two paragraphs, the authority receiving the disclosure must be required not to onward disclose the information without the prior written consent of the Governor in Council.

12.3.2 **Rules and Regulations**

The following regulations have been made under the BTCA.

12.3.2.1 ***The Banks and Trust Companies Regulations, 1991 ("the BTCR")***

The BTCR contain prescribed forms for:

- an application for various classes of banking licence;
- an application for general and restricted trust licences;
- notice of principal office and authorised agents;
- approval for the transfers of shares;
- exemption from the requirement for transfer of shares;
- approval for the use in a name of a restricted word;
- approval for appointment of a director; and
- exemption from approval of directors.

The BTCR provide that an applicant for a restricted trust company licence is exempt from providing many of the particulars required under the BTCA, including:

- details of the names and addresses of its officers and managers, solicitors, auditors;
- an undertaking in writing to provide and set apart a fully paid up capital;
- annual accounts of its holding company;
- names of subsidiary companies;
- statement of assets and liabilities; and
- statement of capital.

The BTCR also provide that restricted trust companies are exempt from the requirement to have their accounts audited and to file their accounts with the Inspector of Bank and Trust Companies.

12.3.2.2 ***The Banks and Trust Companies (No. 2) Regulations, 1991***

These regulations concern an application by a non-licensee to use a restricted word in its name.

12.3.2.3 ***The Banks and Trust Companies (Amendment of Fees) Order, 1996***

This Order amends the fees under the BTCA.

12.3.2.4 ***The Banks and Trust Companies (Application Procedures) Directions, 1991***

These directions set out the procedure for making an application for a bank or trust company licence.

Paragraph 7 sets out "guidelines" for how the Inspector of Bank and Trust Companies interprets "trust business". Sub-paragraph (b) is important, it provides as follows:

"a trust company owned by a professional firm or financial services company which carries on trust business from one office of the professional firm or financial services company situate in one particular jurisdiction may apply for a restricted trust licence."

However, we have been advised by the FSC subsequent to our visit that the Attorney-General recently issued a legal opinion on Section 10(1)(e) of the BTCA which stated that Regulation 7(b) in its application was repugnant to Section 10(1)(e) and the Act. The legal opinion further stated that "the Act is the governing legislation and on well-established principles in law, regulations or directions made under the Act, cannot be repugnant to or inconsistent with it".

12.3.2.5 ***The Banks and Trust Companies (Deposit/Investment) Directions, 1992***

These directions provide that a general trust company is required to make a deposit with the BVI Government as follows:

- if it does not provide registered agent services - US$20,000;
- if it provides "registered services" for no more than 1,500 companies - US$20,000 (there is a typing error in the directions, it should read "registered agent services"); or
- if it provides registered agent services for more than 1,500 companies - US$40,000.

12.3.2.6 ***The Banks and Trust Companies Act, Statutory Instrument 1992 No. 6***

This statutory instrument provides for the interest to be paid on a deposit made with Government.

12.3.2.7 ***The Anti-Money Laundering Code of Practice***

When this is brought into effect it will apply to licensed trust companies.

12.3.3 **Guidance notes**

No guidance has been produced under the BTCA.

The Anti-Money Laundering Guidance Notes, when brought into effect, will apply to all trust companies. These Guidance Notes are discussed in the section on Anti-Money Laundering.

12.3.4 **Supervision - systems and procedures**

12.3.4.1 ***Regulatory structure***

The licensing authority for trust companies is the Governor in Council, that is, Executive Council.

Day-to-day supervision of trust companies is undertaken by an Inspector of Banks and Trust Companies appointed under the BTCA by the Governor in Council. The Inspector is part of the FSD.

12.3.4.2 ***Application process***

Application is made to the Governor in Council via the FSD. The Inspector of Bank and Trust Companies reviews the application, makes such further enquiries and undertakes such checks as he considers appropriate and passes the application to the Governor in Council for approval or otherwise.

Before granting a licence, the Governor in Council must be satisfied that:

- the application is not against the public interest;
- the applicant is qualified to carry on trust business; and
- if the applicant is a company, it has a paid up share capital of at least US $250,0000, or such greater sum as the Governor in Council, by order prescribes.

There is no specific fit and proper test under the BTCA or regulations which applicants must meet. However, we understand that, in practice, fit and proper criteria are applied to applications.

This requirement should also include that all licence holders are subject to "four eyes" control.

An application form is prescribed by Regulation. Applicants for a licence are required to include information on the applicant, its authorised agent, and evidence of appropriate trust business experience. Character references are required for individual applicants, partners of partnership applicants and directors and officers in the case of corporate applicants.

12.3.4.3 ***Principal Office and Authorised Agent***

A trust company must have a principal office in the BVI and two authorised agents approved by the Governor in Council (who must be individuals). The functions of the authorised agents are to act as intermediaries between the licensee and the Governor in Council or the Inspector of Bank and Trust Companies.

Every trust company must notify the Governor in Council in writing of any change of principal office or authorised agent.

12.3.5 **Ongoing Supervision**

Every general trust company is required to provide the Inspector of Bank and Trust Companies on an annual basis with audited financial accounts. As indicated, by virtue of the BTCR, restricted trust companies are exempted from this requirement.

The Inspector of Bank and Trust Companies has commenced an on-site inspection programme in respect of trust companies as provided for by Section 15(2)(b) of BTCA. There is, however, no statutory power giving the Inspector of Bank and Trust Companies access to client files.

The BTCA does not require trust companies to file an auditor's certificate of compliance as is required of company managers under the Company Management Act.

We understand that the majority of trust companies have or are in the process of effecting a professional indemnity insurance policy. However, no guidelines exist for determining in what circumstances insurance will be required.

12.3.6 **Enforcement - systems and procedures**

The main powers of enforcement available under the BTCA are as follows:

Under Section 16(5), the Governor in Council may revoke the licence of a licensee with an unacceptable name.

If the licensee ceases to carry on trust business, becomes insolvent, is carrying on business in a manner detrimental to the public interest, the interests of the beneficiaries of any trust, or to the interests of its creditors, has contravened any provision of the BTCA or has failed to comply with a condition of its licence, the Governor in Council may:

- revoke the licence;
- impose new or additional conditions on the licence;
- substitute any director or officer of the licensee;
- appoint a person to advise the licensee on the proper conduct of its affairs, and to make a report to the Inspector of Bank and Trust Companies;
- appoint a person to assume control of the licensee's affairs; and
- the requiring or the taking of such action by the licensee as the Governor in Council thinks fit.

(c) Where the Governor in Council receives a report from a person appointed to advise the licensee or to assume control of the licensee, he may revoke the licence and instruct the Attorney-General to apply to the Court for the winding up of the licensee.

There is no power for the Inspector of Bank and Trust Companies to apply to the courts for the winding up of a licence holder in the public interest although this may be possible using the Governor in Council's power to take such action as he thinks fit.

12.4 **Issues and recommendations**

12.4.1 **Introduction**

Unlike a number of jurisdictions, both onshore and offshore, the BVI regulates the provision of trust services and, therefore, is already addressing many of the good practices detailed above.

The BVI nevertheless recognises that its current regulatory supervisory regime does need enhancement to fully meet the good practice requirements. The necessary areas of enhancement are detailed below.

12.4.2 **Exclusion of individuals and partnerships**

The terms of reference state that those who provide trust services should be licensed and subject to effective regulation. As indicated, individuals and partnerships are currently excluded from the BTCA and are therefore completely unregulated.

We agree with the BVI that excluding individuals and partnership from regulation as trust service providers is not appropriate and requires notification.

12.4.3 **Exemption of Company Management Act Licensees**

Section 6(2) of BTCA provides that the BTCA does not apply to a person licensed under the Company Management Act, 1990. The effect of this subsection is to permit licensees under the Company Management Act to carry on unlicensed trust business and unlicensed banking business as the prohibitions against unlicensed trust and banking business do not apply. Whilst we accept that the use of conditions can alleviate this risk we consider that the exemption does need to be redrafted to prevent this risk and, therefore, recommend that the exemption should be redrafted accordingly.

12.4.4 **Application for Restricted Trust Licence - Trust Company Owned by Professional Office**

Paragraph 7 of the Banks and Trust Companies (Application Procedures) Directions, 1991 provides that a trust company owned by a professional firm or financial services company which carries on trust business from one office of the professional firm or financial services company situated in one particular jurisdiction may apply for a restricted trust licence.

In our opinion this regulation goes well beyond the definition of restricted trust business in the BTCA. The Financial Services Department advise that they do not apply this provision, but it should be deleted from the Order.

12.4.5 **Restricted Trusts**

We do not consider that the definition of "restricted trusts" in the BTCA is clear. Under Section 10(1)(e) of the BTCA, restricted trust business is trust business undertaken for the persons listed in the application. Persons may include settlors or trust companies. Whilst we understand that there is policy restricting the number of trusts that may be included to 25, we consider it would be preferable that the legislation should be amended to clarify the precise limits of restricted trust business allowed.

We note the exemptions made in favour of applicants for a trust licence. We cannot see the justification for exempting applicants from providing details of the names and addresses of its officers and managers, names of subsidiary companies and statement of assets and liabilities.

Whilst there may be justification for exempting trust companies that act for a small group of associated trusts from the audit requirements under the Act. This matter should be reviewed once a clear definition of restricted trusts has been determined.

12.4.6 **Application process**

We consider that the BTCA makes inadequate provision with regard to the application process. The only conditions that the BTCA requires an applicant to meet are that the applicant is qualified to carry on trust business, that the application is not

against the public interest and that its paid up share capital is at least US$250,000.

We note, for example, that there is no requirement that the applicant, shareholders, beneficial owners, directors and managers meet the "fit and proper" criteria. The term "qualified" is, on its own, too general.

Whilst the Inspector of Bank and Trust Companies is applying a fit and proper criteria, in our view the legislation should be amended to reflect the current practice so ensuring it is on a firm statutory footing.

There should also be a requirement that at least two people are involved in the operation of a licence holder ("four eyes" control), so providing support and oversight.

We also recommend that the Inspector of Banks and Trust Companies is made the licensing authority for trust companies until such time as the FSD obtains operational independence. At this time the FSD itself rather than a single individual should have the licensing powers. (See section 3 for details of FSD independence.)

12.4.7 **Off-site supervision**

We consider that there should be enhancements to the off-site review process. This should include the requirement for regular compliance returns from the licence holder.

12.4.8 **On-site supervision**

Although the Inspector of Bank and Trust Companies has commenced an on-site inspection programme in respect of trust companies, we do not consider that it is effective for the following reasons:

(a) At the time of our visit there were just two officers responsible for the supervision of all licensed banks, trust companies and company managers. Given the volume of work involved, it would be quite impossible for those officers to undertake a proper on-site inspection programme of licensed trust companies.

(b) Section 15(4) provides that the Inspector of Bank and Trust Companies may not have access to the name or title of a settlor or the name or title of a trust without an order of the Court made on the grounds that there are no other reasonable means of obtaining the document.

We do not consider that the Inspector of Bank and Trust Companies can carry out an effective on-site inspection without access to client files to test the processes and procedures of the licensee.

We therefore consider that there is a need for legislative authority for the Inspector of Bank and Trust Companies to undertake on-site inspection visits. Such authority must include the ability to review individual client files to ensure that the BTCA and regulations or guidance made there under are being complied with.

We note that an on-site inspection manual has been produced for banking but not for trust companies. At present, the Financial Services Department does not have sufficient staff resources to prepare such a manual. This needs to be addressed.

The on-site inspection should also verify compliance with the Anti-Money Laundering Code of Practice when it is brought into force.

12.4.9 **Code of practice**

We consider the most appropriate method of meeting international standards in respect of knowing the identity of the settlor, beneficiaries, protector and custodian is via the regulation and supervision of the service provider.

To facilitate the meeting of these standards we consider that the regulatory environment should include an enforceable code of practice.

This code of practice should include requirements relating to:

- knowing the identity of the settlor, protector and custodian on an ongoing basis;
- knowing, where possible the identity of the beneficiaries;
- verifying, so far as is possible, the source of trust assets to ensure they are not of illegal origin;
- ensuring that those who undertake trust work are appropriately trained and competent;

- the delegation of any services provided, including provision of powers of attorney;
- the conduct of trustees provided by licence holders;
- the segregation of trust money and assets; and
- the maintenance of books and records including a copy of the trust deed and other documents relating to the trust.

Where areas in the code are adequately covered by any anti-money laundering regulations then the code may simply make adherence to those regulations a requirement under the code of practice so providing regulatory enforcement powers.

We also consider that breach of the anti-money laundering regulations should be grounds for disciplinary action, including, where appropriate, revocation of a licence.

12.4.10 **Enforcement of regulations**

The Inspector of Bank and Trust Companies should have the power, himself, to take disciplinary action.

In addition to his current powers he should have the ability to:

- petition the court for the winding up of a licence holder in the public interest; and
- "police the perimeter" and conduct investigation of persons suspected of undertaking licensable activities without authorisation.

12.4.11 **Beneficial ownership**

The terms of reference require us to ascertain the means available to regulators and law enforcement agencies to obtain details of the beneficial ownership of trust assets. We consider that the trust service provider should primarily be concerned with the source of the assets settled into trust. This will require the trust service provider to carry out due diligence to verify the identity of the settlor, protector, custodian and any co-trustees. The trust service provider should keep in the BVI the following:

- a copy of the trust deed and any memorandum of wishes;
- details of the settlor and the source of all assets settled into the trust;
- the identity of the protector and any custodians and co-trustees;
- the identity of any known beneficiaries;
- minutes of all decisions taken by the trustees; and
- trust accounts or, at the very least, records which would enable trust accounts to be drawn up.

The above will then be available to law enforcement agencies and the regulator in the event of an investigation taking place.

We consider the current lack of requirements in respect of this are out of line with international standards.

Requirements concerning this could either be introduced via regulation or form part of the anti-money laundering regulations and guidance notes to be issued under the "all crimes" anti-money laundering legislation when it is enacted.

12.4.12 **Insurance**

As noted whilst licence holders are addressing the issue of insurance, no guidelines have been issued, whether external or internal to the FSD, stipulating when insurance should be required. We recommend that these are put in place.

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13 International co-operation

13.1 Introduction

A number of international standards are in place concerning the provision of co-operation between law enforcement and regulatory authorities. These include those established by international regulatory bodies such as IOSCO, IAIS and Basel, the relevant FATF/CFATF recommendations, the "Ten Key Principles for International Financial Information Exchange" recommended by the G7 Finance Ministers in May 1998 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. These, together with good practice standards, are referred to in the Guidance Notes. We were not asked to consider international co-operation relating to purely fiscal matters, but we have considered whether the legislation permits co-operation on criminal tax matters.

The principal international standards and good practice standards set out in the TOR and the Guidance Notes are that:

- there are effective gateways in place through which an OT regulator can disclose confidential information obtainable from licensed bodies, including client information, to foreign regulatory authorities;
- the OT regulator is able, through the imposition of conditions, to require that confidential information it discloses to a foreign regulatory authority is not onward disclosed by the foreign regulatory authority without the consent of the OT regulator;
- an OT regulator is able to safeguard the confidentiality of information disclosed to it by a foreign law enforcement or regulatory authority;
- where necessary, MOUs between an OT regulator and foreign regulatory authorities are in place and that MOUs should contain provisions for safeguarding the confidentiality of information provided;
- the law enforcement authority in an OT has a full range of powers to provide mutual legal assistance to foreign law enforcement authorities, including the obtaining of evidence and the provision of assistance at the investigation stage;
- co-operation between law enforcement authorities should cover all financial crimes (including, for example, fraud, insider trading and market manipulation) and not just drugs related offences or money laundering;
- it should be possible for co-operation to be provided even if the activity under investigation takes place and/or is not a criminal offence in the OT;
- international co-operation should extend to tracing, freezing and confiscating proceeds of crime on behalf of overseas authorities. This should be on an "all crimes" basis (including all financial crimes), as envisaged by the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990;
- no assets should be immune from seizure by virtue of OT laws or through asset protection trusts or flee clauses in trusts;

law enforcement and regulatory authorities should be able to co-operate effectively with each other both domestically and with their counterparts abroad;

- OT regulators can, in the course of their normal duties, obtain information relating to the supervision of licensees which can be disclosed to foreign regulatory authorities through the statutory gateways;
- OT regulators have powers at least equivalent to those contained in the Model "Compulsory Powers Ordinance" annexed to the Guidance Notes to compel the production of information, at the request of foreign regulatory

authorities for their own regulatory purposes, from both regulated and unregulated bodies and persons; and

- adequate resources, including legal advice, are available to OT regulatory and law enforcement authorities for the purposes of international co-operation.

The Terms of Reference ("TOR") for this review require us to consider whether the legislation and systems and procedures in place in the BVI for international co-operation conform to the above international and good practice standards.

Areas for development and action are contained in the issues and recommendations section below.

13.2 **Confidentiality**

13.2.1 **Introduction**

Regulators are usually subject to a duty of confidentiality which may be imposed:

- under a general statute which preserves the confidentiality of information with respect to business which is of a professional nature;
- in legislation which creates or governs the regulator;
- in legislation which provides for the regulation of particular financial services activities; and/or
- under common law.

It is appropriate, and in accordance with international standards, for restrictions to be placed upon the disclosure of confidential information by a regulator. However, in order for a regulator to co-operate effectively with foreign regulatory and law enforcement authorities, there must be gateways through which he can pass confidential information.

13.2.2 **Relevant BVI legislation**

The BVI does not have a single piece of legislation which provides generally for the preservation of confidential information. However, certain duties of confidentiality are imposed at common law and under those statutes which provide for the regulation of particular financial services activities.

There are also legislative gateways through which the appropriate regulator can pass information, although we have been advised by the BVI Government that its policy is not to allow the gateways to be used as a screen for so called "fishing expeditions".

For the purposes of this Report we have reviewed the statutes containing provisions relating to the preservation of confidentiality and to international co-operation generally, including:

- the Bank and Trust Companies Act 1990 and 1995 ("BTCA");
- the Insurance Act 1994 ("IA");
- the Mutual Funds Act 1997 ("MFA");
- the Company Management Acts 1990 and 1995 (together referred to as "CMA");
- the Mutual Legal Assistance (USA) Act 1990 ("MLAT Act");
- the Criminal Justice (International Co-operation) Act 1993 ("CJICA"); and
- the Proceeds of Criminal Conduct Act 1997 ("PCCA").

These statutes are dealt with below and in the section on money laundering.

13.3 **Co-operation between regulatory authorities**

13.3.1 **Legislative gateways**

The BVI has a number of legislative gateways which facilitate co-operation between foreign regulatory authorities. These are detailed below.

13.3.1.1 ***The BTCA, the IA and the CMA***

The BTCA (in section 15), the IA (in section 5) and the CMA (in section 14) contain provisions which enable the relevant regulator to require the production of and/or access to the books and records of a licensee and to demand information or explanations from a licensee or, in the case of the BTCA, from an authorised agent of the licensee.

The BTCA and the CMA restrict the relevant regulator's access to client files and information unless he obtains a Court Order.

The BTCA (in section 24), the IA (in section 70) and the CMA (in section 20) contain similar restrictions on the disclosure of information concerning a licensee or an applicant for a licence. Taken together they provide that any information disclosed to the relevant Inspector, the Commissioner or Deputy Commissioner of Insurance, the Registrar of Companies, the Director of Financial Services or any person acting under their authority in the course of discharging any duty or exercising any power under the relevant Act is absolutely privileged and must not be disclosed except as provided in the Act.

Each Act provides, *inter alia*, that the restriction on disclosure does not apply when the disclosure is made:

- on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings;
- on request by (i) a high ranking officer of a competent authority in an international organisation recognised by the Governor in Council; or (ii) a high ranking officer of the law enforcement authority in a country or jurisdiction approved by the Governor in Council in either case for the purpose of legal assistance in the investigation of any criminal activity; or
- for the purpose of enabling or assisting a foreign regulatory authority in a country or jurisdiction approved by the Governor in Council in discharging duties or exercising powers corresponding to those under the relevant Act or regulations made under the Act.

The Governor in Council has not recognised any international organisations or approved any jurisdictions under the Acts. We have been advised, however, that any request received is considered on its merits and that, if the request is accepted, the Governor in Council will recognise or approve the relevant international organisation or jurisdiction for the purpose of that request.

Each Act provides that, where a disclosure is made, the regulatory or law enforcement authority receiving the disclosure must be required not to make any further disclosure except with the prior written authority of the Governor in Council.

13.3.1.2 ***The MFA***

Section 6 of the MFA requires the Registrar of Mutual Funds to keep registers of registered public funds, recognised private and professional funds and licensed managers and administrators. Information on the registers includes:

- the address of the place of business of the fund, licensed manager or administrator and the address for service in the BVI;
- the name and address of a person in the BVI authorised to act as a representative of the fund, licensed manager or administrator and to accept service on its behalf; and
- the address of any place of business of the fund, licensed manager or administrator outside the jurisdiction.

This information is publicly available and can therefore be disclosed by the Registrar of Mutual Funds to foreign regulatory authorities.

Under section 36 of the MFA, the Registrar of Mutual Funds may direct any person to whom the Act applies to furnish information to him or to provide him with access to any records, books or documents which, in his opinion, are necessary to enable him to ascertain compliance with the Act.

However, section 38(a) of the MFA provides that information relating to any recognised private or professional fund is privileged and may only be disclosed to the Governor in Council or Minister of Finance (or a senior public officer authorised by either of them) or on the order of the Court for the purpose of criminal proceedings.

As the MFA does not contain any regulatory gateway provisions, or any provisions concerning the exchange of confidential

information with other regulators, there is no mechanism whereby information protected under section 38 can be disclosed by the Registrar to foreign regulators for regulatory purposes.

Section 38(b) of the MFA provides that the Governor in Council may direct that any specified information filed by a registered public fund held by the Registrar must be held in confidence and must not be disclosed to any person.

13.3.1.3 ***Companies, trusts and partnerships***

Neither the IBC Act nor the CA permit the Registrar of Companies to disclose non-public information to a regulatory or law enforcement authority.

All information held by the Registrar of Limited Partnerships is available to the public and can therefore be disclosed to foreign regulators. Disclosure of information in respect of companies, trusts and partnerships is discussed further in earlier sections of this Report on each of these areas.

13.3.2 **Compulsory powers**

The BVI does not currently have legislation in place which is equivalent to the Model Compulsory Powers Ordinance annexed to the Guidance Notes. However, the Government is considering the introduction of an "Information Assistance (Financial Services) Act" which is intended to give effect to the provisions of the model ordinance. A bill has been drafted by the Attorney-General's Chambers.

13.3.3 **Memoranda of understanding**

There are no memoranda of understanding in place between the BVI and any foreign regulatory authorities, though we are informed these are being actively considered

13.3.4 **Confidentiality of information received from foreign regulatory authorities**

There are no specific provisions which require the Director of Financial Services, the Inspector of Banks, Trust Companies and Company Managers, the Commissioner of Insurance or the Registrar of Mutual Funds to preserve the confidentiality of information received from foreign regulatory authorities.

13.4 **Co-operation between law enforcement authorities**

13.4.1 **Legislation**

13.4.1.1 ***MLAT Act***

The MLAT Act gives effect, in the BVI, to the Mutual Legal Assistance Treaty concerning the Cayman Islands agreed between the UK and the USA in 1986 ("the Treaty"). The objective of the MLAT Act is to enable the provision of mutual legal assistance between the USA and the BVI for the prosecution and suppression of criminal offences. Virtually identical legislation is in place in the other Caribbean Overseas Territories.

For the purposes of the Treaty, a criminal offence is either conduct which satisfies the dual criminality test, that is, it is conduct which is punishable by imprisonment of more than one year in both the BVI and the USA, or it is one of a number of specific listed offences which include insider trading and fraudulent securities practices.

Article 1 of the Treaty defines the scope of assistance to be provided. The Article states that mutual assistance is to be provided for the investigation, prosecution and suppression of criminal offences covered by the Treaty. With the exception of certain civil and administrative proceedings relating to narcotics, the Treaty does not extend to civil matters.

The Treaty can be used both to obtain information and evidence and for search and seizure. However, information or evidence obtained cannot be used for purposes other than those stated in the request without the approval of the party to whom the request is made.

A person who divulges confidential information in conformity with a request is given immunity from any action for breach of confidentiality.

We have been advised by the BVI Government that it intends to agree to an extension of the scope of the MLAT Act to criminal tax matters.

The Authority under the MLAT Act in the BVI is the Attorney-General. The US Authority is the Department of Justice.

13.4.1.2 ***CJICA***

The CJICA is similar to the UK's Criminal Justice (International Co-operation) Act 1990 (the "UK Act"). It gives substantial effect to the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

The provisions of the CJICA concerning co-operation include:

- the mutual service of process, in criminal matters;
- the mutual provision of evidence in criminal matters;
- the issue of search warrants in the BVI;
- the enforcement in the BVI of overseas forfeiture orders in respect of drugs or drug trafficking offences; and
- extradition for drugs or drug trafficking offences.

13.4.1.3 ***Restrictions on the ability to co-operate in relation to financial offences***

Whilst section 5 of the CJICA allows the taking of evidence without the need for dual criminality, section 6 (relating to the provision of material relevant to overseas investigation) requires the dual criminality test to be satisfied.

13.4.1.4 ***Tracing, freezing and confiscation of proceeds of crime***

The PCCA provides for the enforcement of overseas forfeiture and confiscation orders. As indicated in the section of this Report on money laundering, the list of designated countries under the PCCA is comprehensive.

The PCCA depends upon dual criminality and, therefore, does not extend to conduct which may be a financial crime in a foreign jurisdiction but which is not an indictable offence in BVI (for example, insider trading and market manipulation). Therefore, the provisions which permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

Compliance could be achieved by extending the range of financial crimes in the BVI.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or flee clauses. For the reasons set out in the section of this Report on Trusts, we do not consider asset protection trusts to be significant in BVI. Please see our recommendations concerning flee clauses in the section on Trusts.

13.4.1.5 ***Co-operation between regulatory and law enforcement authorities***

Whilst the contacts between the FSD and the police are good, in order to demonstrate compliance with good practice guidelines there needs to be a formal communication process whereby the police advise the FSD of the findings or investigations relating to fraud and money laundering.

13.4.1.6 ***PCCA***

Sections 32 and 33 of the PCCA provide for the enforcement of external confiscation orders.

13.4.2 **Provision of co-operation**

In the case of a request for assistance emanating from the USA, a request may be made by the Department of Justice to the Attorney-General under the Treaty or by the appropriate US authority under CJICA as described below.

A request for assistance under CJICA may be made by the appropriate authority of any jurisdiction by letter of request sent by that authority to the Attorney-General, although by virtue of section 5, the decision as to whether to grant a request for assistance in obtaining evidence in the BVI lies with the Governor in Council.

The Police Financial Investigation Unit ("the Unit") also provides assistance at an international level.

The following is a summary of enquiries undertaken by the Unit for external sources during 1998:

Interpol enquiries	290
Letters of Request	17
Mutual Legal Assistance Treaty Request Orders	29
Other enquiries responded to	146
Warrants executed	64

13.5 **Requests to other jurisdictions for assistance in criminal and regulatory matters**

In general, in the limited number of cases where requests have been made to other jurisdictions, the BVI Government is satisfied with the assistance which has been provided. However, we have been advised by the Registrar of Mutual Funds that, of ten requests for information made to the SEC in respect of applicants for licences with a US connection, only two have been responded to.

13.6 **Co-operation between regulatory and law enforcement authorities**

There is no specific statutory provision formally enabling the regulator to disclose confidential information to the BVI police.

However we have been advised by the FSD that they do not consider there to be any legal restrictions which prevent the regulators co-operating fully with the police in the BVI and that the level of assistance is significant. This was confirmed in our discussions with the police.

The regulators utilise the police extensively to undertake background checks for them as part of their fit and proper assessment.

13.7 **Co-operation on fiscal matters**

13.7.1 **MLAT Act and Treaty**

Conduct which relates directly or indirectly to the regulation, imposition, calculation or collection of taxes is excluded from the Treaty with the exception of tax fraud and the wilful or dishonest making of false statements to government tax authorities (for example, by submitting a false tax return). Therefore unless the offence falls within the above categories, BVI is unable to co-operate.

13.7.2 **CJICA**

Subject to section 5(3), the CJICA extends to tax offences. Section 5(3) provides that the Governor in Council must not grant a request for evidence that relates to a fiscal offence in respect of which proceedings have not yet been commenced unless:

- the request is from a Commonwealth country, or is made pursuant to a treaty to which the United Kingdom is a party and such a treaty has been made applicable to the BVI; or,
- he is satisfied that the conduct constituting the offence would constitute an offence if committed in the BVI.

This provision matches that contained in Section 4 (3) of the UK Act and does enable BVI to co-operate provided the above criteria are met.

13.8 **Intelligence networks**

The BVI participates in the Overseas Territories Regional Criminal Intelligence System ("OTRCIS"). This system, which is operated out of Miami, assists the Caribbean Overseas Territories law enforcement authorities to combat local criminality occurring in each individual Territory, as well as the threat posed by drug trafficking and organised crime, including money laundering. OTRCIS provides a secure database on information relating to criminal and suspected criminal activity in the Overseas Territories.

13.9 **Support**

13.9.1 **Resources**

There are no BVI Government employees dedicated to the provision of international co-operation.

Legal support on matters of co-operation, both criminal and regulatory, is provided by the Attorney-General's Chambers.

13.9.2 **Egmont Group of Financial Intelligence Units**

The BVI Financial Intelligence Unit ("FIU") is a member of the Egmont Group of Financial Intelligence Units ("Egmont Group"). The Egmont Group is a group of financial intelligence units and similar bodies which was set up to facilitate effective international co-operation between FIUs in the interests of combating money laundering.

Egmont supports the FIU in the BVI through information exchange, training and regional operational workshops.

13.9.3 **White Collar Criminal Intelligence Team**

Additional support is available to the FIU, the police generally and the regulators through the White Collar Criminal Investigation Team ("WCCIT"). This is a joint UK/FBI team which operates out of the FBI's offices in Miami. Currently two UK police officers are seconded to the team. These officers are also sworn in as police officers in each of the Caribbean Overseas Territories.

The role of WCCIT is to undertake and assist in the investigation of white collar crimes involving the US, the UK and the OTs in the Caribbean.

WCCIT does not have authority to initiate investigations in respect of drugs and drug related offences. There are resources available to assist the OTs with anti-drug trafficking investigations through the drugs liaison network in the region. There is also a UK appointed Drugs Law Enforcement Adviser for the OTs available to assist with OT related drugs matters.

13.10 **Issues and recommendations**

13.10.1 **Introduction**

The BVI Government has been progressive in enacting legislation that will assist the regulators in the BVI to co-operate with foreign regulatory authorities. Indeed, the BVI was one of the first jurisdictions to provide for statutory gateways which were inserted into the BCTA and the CMA as long ago as 1995.

The legislation in place in the BVI concerning confidentiality and international co-operation substantially meets the international and good practice standards set out in the Guidance Notes. There are, however, a few issues which we believe that the BVI must address to ensure full compliance with these standards.

We note, in particular, that with the exception of the MFA, there are clear gateways through which the various regulators can pass information to foreign regulatory authorities. Furthermore, in respect of the BTCA, the IA and the CMA, the gateways also enable the relevant BVI regulator to pass information directly to a foreign law enforcement authority for the purpose of legal assistance in the investigation of criminal activity. Subject to paragraph 13.10.2.1 below, this exceeds the good practice standards set out in the Guidance Notes.

The CJICA, which is similar to the UK Act, is a comprehensive piece of legislation which permits a substantial level of co-operation with foreign law enforcement authorities. However, in a few areas we believe that action is required to ensure full compliance with the relevant standards as outlined at paragraph 13.10.3.1 below.

Where the legislation in the BVI fails to meet international standards, the BVI Government has expressed its willingness to enact the necessary legislation. For example:

- a Bill for an Information Assistance (Financial Services) Act, which is intended to provide powers similar to the draft Model Compulsory Powers Ordinance has been drafted; and
- The BVI Government has formally announced that gateway provisions equivalent to those in the other pieces of regulatory legislation will be inserted into the MFA.

We regard this as highly positive.

The areas where we consider specific action is required are detailed below.

13.10.2 **Co-operation between regulatory authorities**

13.10.2.1 ***Scope of existing gateways***

The Guidance Notes require that the statutory gateways should extend to client information. The gateways in the BTCA, the

IA and the CMA are deficient in this respect. This is inevitable given that the regulators, under the above Acts, do not have access to client information without a Court Order.

We recommend that as soon as the legislation is amended to enable the regulator to access client information, the restriction upon the disclosure of client information to a foreign regulatory authority is removed. It is acceptable for the disclosure of client information to be restricted in accordance with regulatory need and to be subject to strict conditions.

We have considered whether the fact that the Governor in Council has not recognised any countries or jurisdictions, pursuant to the gateway provisions in the BTCA, the IA and the CMA, is an inhibitor to the effective sharing of information with regulators in other jurisdictions under these statutes. In our opinion, provided that the Governor in Council, or preferably an independent regulatory authority continues to recognise or approve jurisdictions on an *ad hoc* basis for the purposes of providing assistance, the gateway provisions comply with international standards. Therefore, the need for lists of recognised or approved jurisdictions may be reconsidered and, if no longer necessary, removed from the legislation.

13.10.2.2 ***Mutual Funds Act***

We consider that in failing to provide gateway provisions equivalent to those contained in the BTCA, the IA and the CMA, the MFA fails to comply with IOSCO Principles 11 and 13 and prevents the Registrar from fully complying with IOSCO Principle 12. The lack of gateways also represents a failure to comply with FATF Recommendation 32.

In the absence of over-riding gateway provisions, we are of the opinion that the following provisions of the MFA are not in line with IOSCO Principles 11 and 13:

- section 38(1) which imposes restrictions upon the disclosure of information relating to private and professional funds; and
- section 38(2) which, in respect of public funds, gives the Governor in Council the power to direct that specified information held by the Registrar shall be held in confidence and shall not be disclosed to any person.

In order to comply with IOSCO Principle 12, a mechanism for sharing information will need to be developed either in relation to funds or, preferably, in relation to co-operation across the range of regulated activities. However, no mechanism can be effective in the absence of regulatory gateways.

This restriction is, therefore, not in compliance with the Guidance Notes in respect of both international co-operation and the supervision of the securities sector.

We recommend that section 38 of the MFA is repealed and replaced with provisions providing appropriate gateways for the sharing of confidential information with other regulators or, at the very least, gateways over-riding section 38 are inserted into the MFA.

Such provisions should contain appropriate safeguards in respect of continuing confidentiality following the transmission of information. Gateways equivalent to those contained in the BTCA, the IA and the CMA, amended to reflect the recommendations made in this Report, would meet international and good practice standards.

Consideration should also be given to entering into formal MOUs with recognised jurisdictions where the foreign functionaries of a fund are located and with regulators of group companies of which the BVI licence holders are members. If necessary the Mutual Funds Act should be amended to facilitate this.

13.10.2.3 ***Bill for the Information Assistance (Financial Services) Act***

The Model Compulsory Powers Ordinance was developed by the UK and discussed with the OTs at a number of Attorney-Generals' conferences. It is designed to provide OT regulators with powers to compel the production of information from both regulated and unregulated individuals and entities in order to satisfy a request for assistance made by a foreign regulator. As regulatory requests are civil, rather than criminal, they cannot generally be made under legislation that enables the provision of assistance in criminal matters.

The draft Bill for the Information Assistance (Financial Services) Act ("the draft Bill") is similar to the Model Compulsory Powers Ordinance, although there is no power for the Director to examine a person under oath nor is there a power to use the information obtained in any subsequent case of perjury.

The absence of a capability to use information supplied under the draft Bill in cases of perjury and the absence of a power for

the Director to take evidence under oath (although a Magistrate can) are weaknesses as they remove the main sanction available against people who provide contradictory testimony in subsequent proceedings.

There is a need to provide assistance to other regulators in the conduct of their investigations. However, this will be addressed via the Information Assistance (Financial Services) Act, if this is enacted.

We recommend that the draft Bill, amended in accordance with the comments above, is enacted as soon as possible.

13.10.2.4 ***MOUs***

As indicated, there are no MOUs in place between regulators in the BVI and foreign regulatory authorities.

The TORs require that MOUs are put in place where necessary. The legislation does not require MOUs to be put in place and there is no evidence that the lack of MOUs is preventing or hindering the regulators in the BVI from co-operating with foreign regulatory authorities.

Nevertheless, we consider that MOUs are a useful tool and, where in place, facilitate the prompt exchange of information between regulators.

We recommend that the BVI Government consider agreeing MOUs with those regulatory authorities with whom the BVI regulators have more frequent contact.

13.10.2.5 ***Confidentiality of information received***

The Guidance Notes require that regulators are able to safeguard the confidentiality of information provided to them by foreign regulatory or law enforcement authorities. There is no specific statutory provision concerning this.

Whilst a level of confidentiality can be inferred from the confidentiality obligations imposed on the regulators in the BVI in the various financial services statutes, the position may be considered ambiguous by foreign regulatory authorities and we therefore consider that clear statutory provision should be made.

We recommend that, in order to facilitate international co-operation and meet international and good practice standards, specific provision for the confidentiality of information received from foreign regulators and law enforcement authorities should be enacted.

13.10.3 **Co-operation between law enforcement authorities**

13.10.3.1 ***MLAT Act***

Our discussions with the US Department of Justice indicate that the Department is relatively comfortable with the operation of the MLAT Act and Treaty in practice, although they consider that the level of resources available to provide a swift response are limited.

Due to a lack of available data we have not been able to determine whether this concern is justified. However, the introduction by the Attorney-General's Chambers of a log to monitor requests and the speed of response should highlight whether there are delays in providing an adequate response.

The US Securities and Exchange Commission ("SEC") expressed concern as to the use of the Treaty as they had requests made under it refused on a number of occasions. It is our view that the introduction of the Information Assistance (Financial Services) Act may resolve a number of their current difficulties in respect of obtaining appropriate information.

13.10.3.2 ***Criminal Justice (International Co-operation) Act 1993***

The CJICA is similar to the UK Act and provides for a significant level of international co-operation. In particular, there is no requirement for dual criminality on an application from a foreign law enforcement authority to obtain evidence in the BVI in connection with foreign criminal proceedings.

However, there are a number of differences between CJICA and the UK Act, the most significant of which are:

- the CJICA does not contain provisions for the transfer of prisoners (contained in Sections 5 and 6 of the UK Act); and

- Section 9(c)(i) of Schedule 3 of CJICA and the UK Act vary in that in CJICA a person is only guilty of an offence if he recklessly makes a statement which "he knows to be false" whereas in the UK Act the requirement is simply that the information "is false".

Unless provisions are contained in legislation outside the scope of this review, we recommend that equivalent provisions are inserted into CJICA concerning the transfer of prisoners and that Section 9(1)(c) of CJICA be amended to follow the UK model.

Furthermore, in two places the CJICA makes reference to the "Secretary of State" (Sections 6(7)and 20(3)). This appears to be an error and if so the CJICA should be amended.

13.10.3.3 ***Restrictions on the ability to co-operate in relation to financial offences***

Given the requirement for dual criminality in relation to the exchange of information under the MLAT Act, it may not be possible to provide co-operation in respect of conduct which may constitute a financial services criminal offence in the USA but which does not constitute a criminal offence in the BVI. However, a number of matters which are not offences in the BVI are specified in the Treaty.

13.10.3.4 ***Tracing, freezing and confiscation of proceeds of crime***

Both the CJICA and the PCCA provide for the enforcement of overseas forfeiture or confiscation orders. Effect is given to the CJICA powers by the Criminal Justice (International Co-operation) (Enforcement of Overseas Forfeiture Orders) Order, 1996 ("CJICA Forfeiture Order"). The CJICA applies to drug trafficking offences and the PCCA to other crimes.

The CJICA Forfeiture Order makes provision for restraint orders.

The PCCA depends upon dual criminality and therefore does not extend to conduct which may be a financial crime in a foreign jurisdiction but which is not an indictable offence in the BVI (for example, insider trading and market manipulation). Therefore, the provisions which permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

Compliance could be achieved by extending the range of financial crimes in the BVI.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or flee clauses. For the reasons set out in the section of this Report on Trusts, we do not consider asset protection trusts to be significant in the BVI. Please see our recommendations concerning flee clauses in the section on Trusts.

13.10.4 **Co-operation between regulatory and law enforcement authorities**

Whilst the contacts between the FSD and the police are good, in order to demonstrate compliance with good practice guidelines, there needs to be a formal communication process whereby the police advise the FSD of the findings or investigations relating to fraud and money laundering and we recommend that appropriate procedures are put in place.

13.10.5 **Transparency in co-operation**

The Director of Financial Services is of the opinion that the gateways for international co-operation are not always well understood by those requesting assistance. Failure to utilise the appropriate gateway can lead to delay and the impression of a lack of co-operation.

To address this issue the BVI should produce and publish (possibly via the World Wide Web) guidance on the international co-operative gateways for both civil and criminal requests for assistance.

We, therefore, recommend that the BVI Government should produce guidance notes for regulators and criminal authorities in other jurisdictions detailing the types of co-operation available and the appropriate procedures for seeking co-operation.

13.10.6 **WCCIT**

To facilitate the full assistance of WCCIT in relation to money laundering offences we recommend that the current exclusion of drug related matters from its scope is removed.

13.10.7 **Resources**

Currently, the BVI Government does not retain sufficient data to provide an indication as to whether there are sufficient resources available to provide information when requested (with the exception of the FIU, which is dealt with under anti-money laundering). We recommend that appropriate information monitoring procedures are put in place.

We welcome your comments on this site.

Prepared 27 October 2000

14 Anti-money laundering

14.1 Introduction

A number of international standards are in place setting legislative and practical measures that should be taken to combat money laundering. These are contained principally in the FATF 40 Recommendations and the CFATF 19 Recommendations, the Vienna Convention and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. We are asked to consider to what extent the OTs apply the standards set out in these documents together with those contained in the EC Money Laundering Directive (June 1991).

Our review falls into two distinct parts. The first is a review of the legislation, regulations and guidelines in place. The second is a review of the implementation of the legislation, regulations and guidelines, especially as regards the reporting, handling and investigation of suspicious transaction reports.

14.2 Factual assessment

14.2.1 Legislation

14.2.1.1 *Introduction*

The BVI has three pieces of legislation dealing with money laundering:

- the Drug Trafficking Offences Act, 1987, as amended by the Drug Trafficking Offences (Amendment) Ordinance, 1990 ("DTOA");
- the Criminal Justice (International Co-operation) Act, 1993 ("CJICA"); and
- the Proceeds of Criminal Conduct Act ("PCCA").

A Drug Trafficking Offences (Amendment) Bill was in draft form at the time of our review. We are informed that since our review, this Bill has been passed as the Drug Trafficking Offences Act, 1992, as amended by the Drug Trafficking Offences (Amendment) Act 2000.

14.2.1.2 *DTOA*

14.2.1.3 *Offences*

The DTOA was enacted to implement the drug trafficking aspects of the Vienna Convention in the BVI. The following money laundering offences were created by the DTOA:

- assisting another to retain the benefit of drug trafficking (Section 23); and
- prejudicing an investigation (Section 33).

The *mens rea* for the offence of assisting another to retain the benefit of drug trafficking is "knowing or believing" that another person carries on or has carried on or benefited from drug trafficking.

The offence provisions apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit offences under the DTOA.

14.2.1.4 *Other provisions of the DTOA*

Sections 5 - 8 of the DTOA enable the Court to confiscate the proceeds of drug trafficking and sections 10 - 13 give the Court the power to make restraint orders and charging orders.

Sections 24 and 25 of the DTOA establish procedures for registering at Court and enforcing foreign confiscation orders made

by the court of a country designated under the Drug Trafficking Offences (Designated Countries and Territories) Order, 1996. The list of countries designated is comprehensive.

The DT OA also provides for production orders (Section 26) and search warrants (Section 27).

Section 34 of the DTOA enables a customs officer or police officer to seize and detain cash in a sum exceeding US$10,000, or its equivalent in another currency, which is being imported into or exported from the BVI and which the officer has reasonable grounds for suspecting represents the proceeds of drug trafficking.

Section 23 of the DTOA provides for the reporting of suspicious transactions to a police officer. The section provides that if a person discloses to a police officer his suspicion or belief that the relevant funds which he is handling might be the proceeds of drug trafficking:

- that disclosure shall not amount to a breach of any duty of confidentiality imposed by contract; and
- provided the disclosure is made in accordance with the section, he does not commit an offence in contravention of the section.

The reporting of suspicious transactions under the DTOA is not compulsory.

As its name suggests, the DTOA is concerned with drug trafficking only and its money laundering provisions are, therefore, limited to those dealing in the proceeds of the underlying (or "predicate") offence of drug trafficking.

14.2.1.5 ***Drug Trafficking Offences (Amendment) Bill***

If enacted, this Bill will amend the DTOA. The following provisions of the Bill relate to money laundering:

- the protection given to a person making a disclosure will be extended such that the disclosure shall not amount to a breach of any duty of confidentiality imposed by statute or otherwise (as opposed to "imposed by contract" under the current DTOA);
- a police officer to whom a disclosure is made will be able to onward disclose the information to the Reporting Authority and to a foreign law enforcement authority;
- the offence of acquisition or use of property representing the proceeds of drug trafficking will be created (the *mens rea* being "actual knowledge");
- the offence of concealing or transferring property representing the proceeds of drug trafficking will be created;
- the offence of tipping off will be created; and
- reporting suspicious transactions in relation to drug trafficking will be made compulsory through the introduction of a "failure to disclose" offence.

As stated above, we are informed that this Bill has been enacted since the date of our review.

14.2.1.6 ***CJICA***

14.2.1.7 ***General provisions***

The CJICA enables the BVI to co-operate with other countries in criminal proceedings and investigations and, in so doing, gives effect to the mutual legal assistance provisions of the Vienna Convention. This is discussed further in the section on international co-operation.

The CJICA also provides for the enforcement of overseas forfeiture orders in drug cases.

14.2.1.8 ***Drug trafficking offences***

Section 11 of the CJICA creates the offence of concealing or transferring the proceeds of drug trafficking and the offence of acquiring another person's proceeds of drug trafficking. The latter offence does not extend to possessing or using another's proceeds of drug trafficking.

The *mens rea* for the concealing or transferring the proceeds of another's drug trafficking is "knowing or having reasonable

grounds to suspect" that the property represents the proceeds of drug trafficking.

The offence provisions of the CJICA apply to "persons". A "person" includes an individual and a corporate body. Therefore both may commit offences under the CJICA.

14.2.1.9 ***PCCA***

The BVI has introduced "all crimes" anti-money laundering legislation through the PCCA, which was brought into force on 2 January 1998. The money laundering provisions in the PCCA apply to "criminal conduct" which is defined as an indictable offence or conduct taking place outside the jurisdiction which would constitute such an offence if it had occurred in the BVI. This concept is known as "dual criminality". Drug trafficking offences are specifically excluded.

The following money laundering offences were created by the PCCA:

- assisting another to retain the benefit of criminal conduct (Section 28);
- acquisition, possession or use of proceeds of criminal conduct (Section 29);
- concealing or transferring the proceeds of criminal conduct (Section 30); and
- tipping off (Section 31).

The *mens rea* for the above offences is as follows:

- the offence of assisting: "actual knowledge or suspicion" that the person assisted is or has been engaged in criminal conduct;
- the offence of acquisition possession or use: "actual knowledge" that the property is the proceeds of criminal conduct; and
- the offence of concealing or transferring: "knowing or having reasonable grounds for suspecting" that the property is the proceeds of criminal conduct.

Sections 28 and 29 of the PCCA provide for reporting suspicious transactions to the Reporting Authority appointed under Section 27. Both sections provide that if a person makes a suspicious transaction disclosure to the Reporting Authority:

- that disclosure shall not amount to a breach of any duty of confidentiality imposed by statute or give rise to civil liability;
- provided the disclosure is made in accordance with the section, he does not commit an offence in contravention of the section; and
- will provide a defence to any conduct which would otherwise amount to an offence.

Sections 6 to 10 of the PCCA provide for confiscation orders and Sections 16 to 18 provide for the making of restraint orders and charging orders.

Section 36 enables the High Court to make an Order for the production of material relevant to an investigation into money laundering on the application of a police officer and Section 37 enables a police officer to apply to the Court for a search warrant.

Sections 32 and 33 of the PCCA provide for the registration and enforcement of external confiscation orders. An Order designating countries to which the Sections apply has been issued.

14.2.2 **Regulations**

The following regulations and orders have been made:

- the Criminal Justice (International Co-operation) (Enforcement of Overseas Forfeiture Orders) Order, 1996;
- the Drug Trafficking Offences (Designated Countries and Territories) Order, 1996; and
- the Reporting Authority (Constitution and Procedures) Order, 1998; and

- the Proceeds of Criminal Conduct (Designated Countries and Territories) Order, 1999.

The Anti-Money Laundering Code of Practice, 1999 ("the Code of Practice") was published in the Gazette in October 1999 but it has not yet been brought into force. It is designed to be equivalent to the UK Money Laundering Regulations, 1993.

14.2.2.1 ***Reporting Authority (Constitution and Procedures) Order 1998***

This was introduced under the PCCA and sets out the structure and membership of the Reporting Authority.

14.2.2.2 ***Code of Practice***

As stated, the Code of Practice, which was made under section 27(1) of the PCCA, has not yet been brought into force.

When brought into operation, the Code of Practice will have statutory effect and failure to comply with its provisions will be punishable by a fine of up to US$15,000.

The Code of Practice will apply to "regulated persons" who will include persons carrying on:

- banking, trust, insurance or company management business;
- business as a mutual fund or providing services as manager or administrator of a mutual fund;
- money transmission services or cheque encashment facilities; and
- the business of acting as company secretary of bodies corporate.

The Code of Practice contains a number of requirements, including:

- to maintain procedures concerning client identification, record keeping and internal reporting;
- to establish internal controls to assist in preventing money laundering;
- to make staff aware of the requirements of the Code of Practice and the firm's compliance procedures;
- to train staff appropriately;
- to maintain a register of money laundering enquiries; and
- to appoint a compliance officer, approved by the Director of Financial Services.

The Director of Financial Services ("the Director") or a person nominated by him may conduct a due diligence audit on compliance with the Code of Practice. Furthermore, the Director may, for the purposes of the Code of Practice, issue directives. The Code of Practice does not indicate whether, in conducting a due diligence audit, the Director has access to client files.

There is no requirement for the audit of a licensee to include an assessment of compliance with the Code of Practice.

We have been advised by FSD and representatives of the private sector that the delay in bringing the Code of Practice into force has been caused, in part, by concerns expressed by the private sector which the Government is considering.

However, as noted, reporting of suspicious transactions under the PCCA will remain voluntary.

14.2.3 **Guidance Notes**

14.2.3.1 ***JAMLCC Guidance Notes***

Draft guidance notes have been compiled by the Joint Anti-Money Laundering Co-ordinating Committee ("JAMLCC").

The JAMLCC was established in 1999 to co-ordinate all the BVI's anti-money laundering initiatives. It is a broad based, multi-disciplinary committee which comprises private and public sector representatives. The former includes members of the legal, trustee, banking and tourism sectors and the latter, representatives of the Department of Public Information, Post Office, Police, Customs and the Ministry of Finance.

We are advised by the FSD that the draft guidance notes are based on those published in the UK and Guernsey.

14.2.3.2 ***Other guidance/codes***

The Association of Registered Agents has introduced a voluntary Code of Conduct for its members. Whilst not directly related to anti-money laundering, it is designed to deter the use of the jurisdiction for criminal purposes. Amongst its requirements are "know your customer" provisions. It is not possible to gauge adherence to this Code.

14.2.4 **Fiscal offences**

Fiscal offences are not predicate offences under the PCCA, although other offences caught by the PCCA, such as fraud, may have a fiscal element in which case co-operation can be provided.

14.2.5 **Anti-money laundering - framework, system and procedures**

14.2.5.1 ***Reporting Authority***

The Reporting Authority was established in 1998 under the PCCA. It comprises:

- a Senior Crown Counsel in the Attorney-General's Chambers (who, for the purposes of this role, does not report to the Attorney-General);
- the Director of the Financial Services Department, who is the Chairman;
- the Head of the Financial Investigation Unit ("the Unit"); and
- the Deputy Director of the FSD, who acts as Secretary to the Reporting Authority.

The Reporting Authority is not a government agency but a separately constituted body which functions as the BVI's Financial Intelligence Unit ("FIU"). The role of the FIU is gathering intelligence, rather than financial investigation.

The Reporting Authority meets on an *ad hoc* basis.

Disclosures of suspicious transactions under the PCCA 1997 are made under confidential cover to the Secretary of the Reporting Authority and their receipt is acknowledged within 48 hours. The Secretary of the FIU reviews the suspicious transaction reports and if, in the Secretary's view, the report discloses sufficient details, the Secretary will refer it to the Police Financial Investigations Unit ('the Unit') for formal investigation.

Reports under the DTOA are made to the police who are responsible for their investigation. The reports are normally passed to, and investigated by, the Drugs Squad although the Unit may also become involved.

There are no requirements to report transactions above a certain value.

Since the establishment of the Reporting Authority in 1998, a total of 60 suspicious transaction reports have been made. This includes 20 in 1998, 22 in 1999 and 12 made during 2000 to date. With the exception of two reports that contained insufficient information (one was an unknown potential client who had been turned away by a financial institution) all reports have been referred to the Unit for formal investigation.

Whilst there is a formal arrangement for the Reporting Authority to pass information to the FIU, there appears to be no formal arrangement for feedback from the FIU to the Reporting Authority. This means the Reporting Authority is not always being kept aware of the results of reports made by it to the Unit.

14.2.5.2 ***The Police Financial Investigations Unit***

The Unit is a three-man team which has primary responsibility for the investigation of complicated fraud, bank fraud and suspicious transaction reports. The Unit is staffed by an Inspector on secondment from the UK Police Force, who is the Head of the Unit, and two Acting Sergeants. There is no participation of Customs Department in the Unit.

The Unit is a stand-alone function within the police force. Its database of information is not available to members of the force outside the Unit. The Unit considers this to be vital to maintain the security of the information held.

The Inspector is a Technical Co-operation Officer funded by the Department for International Development. His term of office is due to expire in early 2001. We understand that there will be no further DFID funding for this post.

It is the view of the Head of the Unit that the Unit is not adequately staffed and that there is a need for additional police officers to perform its functions efficiently. This view is supported by the recent CFATF Report.

The Unit receives reports of suspicious transactions from the Reporting Authority, and directly from individuals and institutions, and investigates them. The majority of the reports relate to IBCs.

The Unit may only pass information resulting from suspicious transaction reports to overseas law enforcement authorities with the approval of the Attorney-General. The head of the Unit does not consider that this inhibits co-operation but rather that the consultation provides him the opportunity to ensure that the legislative requirements have been complied with before the information is passed on.

Notwithstanding that there is no direct participation by other law enforcement agencies (for example, Customs Department), the Unit considers that it has no difficulty in sourcing information on arrested persons or companies from the Immigration Department, the Customs Department and other Government Agencies because of its good relationship with them. The Unit considers that information is shared willingly and confidentially. Additionally, meetings between the various Government Departments are held on an *ad hoc* basis and intelligence is shared at these meetings.

To date, the Unit has investigated 17 reports passed to it by the Reporting Authority.

In 1998 and 1999 the Unit did not serve any Restraint/Charging Orders in the BVI, and there were no seizures of assets.

We understand that there are some administrative delays in the Unit, particularly in providing feedback to the FIU. However we understand that there are no delays in commencing investigations.

Representatives of the banking industry commented to us that they have not received feedback from the Unit in respect of reports made.

14.2.5.3 ***JAMLCC***

The JAMLCC has overall responsibility for developing and implementing the BVI's anti-money laundering infrastructure and drafted the Guidance Notes on the Prevention of Money Laundering. The Guidance Notes are not intended to be statutorily enforceable. It is proposed that the Court may take them into account when determining whether a person has complied with the Code of Practice.

14.2.5.4 ***Attorney-General's Chambers***

The Attorney-General's Chambers comprise eight lawyers together with the Attorney-General himself. There are currently vacancies for a Director of Public Prosecutions and a Senior Crown Counsel.

Requests for co-operation are dealt with by the AG himself with the assistance of Senior Crown Counsel. The majority of requests relate to IBCs and are received from Europe under the Criminal Justice (International Co-operation) Act. There have been delays in responding to requests for assistance, but the Attorney-General's Chambers consider that these problems have now been resolved. To facilitate the speed of response, the AG will commence his own enquiry where he is aware that an issue has arisen in relation to an IBC (e.g. through press reports).

Whilst records of the time taken to respond to requests were not previously kept, a system has recently been introduced to track requests from date received to date of response.

Confirmation that responses are to the satisfaction of the requesting authority is not currently sought.

14.2.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies is primarily via participation in the CFATF, of which the Director is currently the Chairman, the Egmont Group and discussions with the private sector.

14.2.7 **Other measures to avoid money laundering**

The Educational Sub-Committee of JAMLCC has:

- produced an anti-money laundering video which includes a panel discussion with commentary from the Deputy Director of Financial Services, the Head of the Unit and the President of the Association of Registered Agents; and

- undertaken educational visits to secondary schools in the BVI.

There are no direct measures to detect or monitor cross-border transportation of cash and bearer instruments. Where cash is discovered, however, and it is suspected that it is the proceeds of drug trafficking, it is held and the person carrying it is questioned as to its source.

There are no requirements to report transactions above a certain value.

There is no measurement system in place recording the international flow and reflows of cash, into or out of the BVI.

The legislation in the BVI does not distinguish between launderers who are public officials and others.

The BVI has power under the MLAT to share assets seized. There is no other jurisdiction with which the BVI has this arrangement.

14.3 **Issues and recommendations**

14.3.1 **Introduction**

The BVI has introduced a number of legislative provisions designed to bring it into compliance with international standards, including modern all crimes anti-money laundering legislation. The legislation taken as a whole is reasonably extensive and contains much of the material and covers most of the issues that we would expect in a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of the BVI's commitment to prevent money laundering.

There is, however, a need to complete the process. The enactment of the Drug Trafficking Offences (Amendment) Bill and the bringing into force of the Code of Practice will go a considerable way towards achieving this. We understand that the Bill has been enacted since the date of our review.

Additionally, the recommendations contained in the other sections of this Report relating to changes in the regulatory structure and international co-operation should be implemented. Regulatory on-site visits should also cover compliance with the PCMLR.

14.3.2 **Legislation**

14.3.2.1 ***DTOA and CJICA***

As indicated above, the offences of concealing, transferring or acquiring the proceeds of another's drug trafficking are created by the CJICA. However, the offences of tipping off and possessing and using another's proceeds of drug trafficking are not provided for in either the CJICA or the DTOA. The BVI does not, therefore, fully comply with FATF Recommendation 17 and does not yet give full effect to article 3 of the Vienna Convention.

The above offences are all contained in the Bill to amend the DTOA. However, we consider that the *mens rea* for the offence of acquisition and use should be extended to cover "reasonable grounds to suspect."

The *mens rea* for the DTOA offence of assisting another to retain the benefit of drug trafficking is "knowing or having actual suspicion" that the person assisted in carrying on or has carried on drug trafficking. We consider that the *mens rea* for the offences should be extended to cover a person who "had reasonable grounds to suspect" that the proceeds were derived from drug trafficking. Provided that the same change is made to the PCCA, this will bring the BVI into line with what is envisaged by CFATF Recommendation 4.

The *mens rea* for the CJICCA offences of concealing or transferring or acquiring the proceeds of another's drug trafficking is "knowing or having reasonable grounds to suspect" that the property represents the proceeds of another's drug trafficking. This complies with international standards.

The Bill to amend the DTOA includes all the above offences.

We consider that the *mens rea* for the offences of "assisting" and "acquiring" should be extended to cover situations where the defendant "ought to have known" that the proceeds were derived from crime. This would bring the BVI into compliance with what is envisaged by CFATF Recommendation 4.

We recommend that the BVI should introduce compulsory reporting of suspicious transactions in relation to drug trafficking

to assist in creating a culture of disclosure in appropriate circumstances.

14.3.2.2 ***PCCA***

Sections 32 and 33 of the PCCA provide for registering and enforcing of external confiscation orders.

As indicated, the *mens rea* for the offence of assisting is "actual knowledge" or "actual suspicion" and for the offence of acquisition is "actual knowledge". We consider that the *mens rea* for each offence should extend to "having reasonable grounds to suspect" as envisaged by CFATF Recommendation 4.

We note that the BVI does not distinguish between launderers who are public officials and others, as envisaged by CFATF Recommendation 5. Sentencing discretion should enable the judiciary to set higher penalties for public officials who commit money laundering offences. We do not know whether sentencing policy reflects this.

There is no requirement to report transactions above a certain value. Whilst such a system is envisaged by FATF Recommendation 23 and CFATF Recommendation 14, the Recommendations do not make such a provision mandatory. We consider that a decision upon whether such a reporting regime should be implemented is for the jurisdiction itself to take rather than an international standard.

14.3.3 **Anti-Money Laundering Code**

We are concerned by the delay in the introduction of an enforceable Code of Practice.

Whilst the effectiveness of the Code in practice will only become clear over time, the contents of the Code, when taken in conjunction with the JAMLCC Guidance Notes, is generally in line with FATF Recommendations 8, 9, 10, 11, 12, 18, 19, 20 and 21 and CFATF Recommendation 13. However, until the Code and the Guidance Notes are brought fully into force, the BVI will not be in compliance with these Recommendations.

The Regulation should require know your customer information in respect of existing as well as future clients.

We note that the Director of Financial Services ("the Director") or a person nominated by him may conduct a due diligence audit on compliance with the Code of Practice. However, the Code of Practice does not indicate whether, in conducting a due diligence audit, the Director has access to client files. We consider that he must have such access if the audit is to be effective.

There is no requirement for the audit of a licensee to include assessment of compliance with the Code of Practice though provisions do exist for a Compliance Officer review of compliance. The absence of a strict audit requirement weakens compliance with FATF Recommendation 19 which requires financial institutions to develop a programme, including an audit function, to test its anti-money laundering system.

If an audit requirement is inserted into the Code and anyone undertaking a due diligence audit, including the Director, is given access to client files, we consider that the BVI will be in compliance with FATF Recommendation 19.

Given the amount of introduced business in the BVI, particularly in the area of company formations, it will be necessary to include specific regulatory testing to ensure that introducers are complying with the requirements imposed by their contractual relationship with the regulated person.

14.3.4 **Guidance notes**

Until the Code of Practice is in place the Guidance Notes cannot become fully effective. Therefore the BVI is not currently in compliance with FATF Recommendation 28.

14.3.5 **Framework, systems, procedures and resources**

14.3.5.1 ***Reporting Authority/FIU***

We consider that the current practice whereby the Secretary of the FIU is solely responsible for determining whether a suspicious report is passed to the Unit is not appropriate as it places too much reliance on a single individual. We recommend that the FIU, as a group, or a sub-committee of the FIU, should review every suspicious transaction report submitted and determine whether or not it should be passed on to the Unit for investigation. The reasons for a decision not to pass a report to the Unit should be fully documented. This would ensure compliance with the "four eyes" principle.

The reporting authorities under the DTOA (the police) and the PCCA are different. We do not consider that this approach is logical and it may result in a full analysis of reports not being made or in a lack of consistency in approach. Furthermore, it is not always clear to a person making a report whether the suspicion relates to the proceeds of drug trafficking or some other offence. We therefore recommend that a single body should act as the Reporting Authority for both the DTOA and the PCCA. This could be the PCCA Reporting Authority.

As the Reporting Authority is responsible for the overall implementation of the Code of Practice, in order to ensure compliance it must, possibly in conjunction with the FSD, establish an effective surveillance system for those persons covered by the Code but not regulated by the FSD. This will allow it to meet the requirements of FATF Recommendation 27 in respect of non-regulated bodies.

There is also a need for a formalised system of ensuring that international trends in money laundering can be monitored and acted upon. This will facilitate compliance with FATF Recommendation 13.

14.3.5.2 ***The Unit***

We are concerned that DFID funding for the Head of the Unit will cease on the termination of the contract of the current Head early in 2001. Whilst some succession planning exists and we note that the FCO will be funding the post of Head of the Unit on a graduated basis over the three years after the DFID contract ends, the Unit plays an essential role in the BVI's anti-money laundering efforts and its workload is likely to increase when the Code of Practice is brought into force and as greater understanding of the obligations under the legislation is understood by the private sector.

We consider that the need to staff the Unit with experienced officers will inevitably increase and provision for this should be made as soon as possible. The increase in resources should also help overcome the delays in reporting back to the FIU, referred to above.

We also consider that it would be advantageous for a member of Customs and Excise Department to be seconded to the Unit. This would facilitate co-operation between the police and Customs on information gathering and sharing.

We fully support the continuation of the Unit as a stand-alone operation in the police force with a discrete, controlled access database. This should not, however, preclude the use of financial intelligence in other police investigations in appropriate circumstances.

We see no immediate need to remove the requirement for the Attorney-General's approval for passing details of a suspicious transaction to law enforcement authorities outside the jurisdiction. This procedure is in line with FATF Recommendation 32 which calls for strict safeguards to ensure that the exchange of such information is consistent with national and international provisions on privacy and data protection. Nevertheless, this should be periodically reviewed to ensure no delays in remitting appropriate information are occurring.

Whilst there is a formal arrangement for the exchange of information from the Reporting Authority to the FIU, there appears to be no formal arrangement for feedback from the FIU to the Reporting Authority. This means the Reporting Authority is not always being kept aware of the results of reports made by it to the Unit.

We therefore recommend that:

- resources should be increased to cope with the additional workload that will result from the changes to the legislation referred to above and the introduction of the Code of Practice and the Guidance Notes;
- a member of Customs and Excise Department should be seconded to join the Unit to maximise inter-agency co-operation; and
- a formal arrangement for the feedback of information from the Unit to the FIU should be introduced.

14.3.5.3 ***The Attorney-General's Chambers***

The Attorney-General considers that his funding and resources are sufficient to enable him to undertake his function. Without a full review of the other commitments of the Chambers, it is not possible to confirm this view. However, any further delays in responding to overseas requests for co-operation would indicate that the level of resources in the Chambers is insufficient.

14.3.6 **Monitoring developments in anti-money laundering techniques**

The current limited resources and lack of a formalised process for monitoring developments means that the BVI may not always be up to date.

14.3.7 **Monitoring of compliance by regulated institutions**

The lack of effective on-site inspection programmes for licensed institutions means that FATF Recommendation 26 and CFATF Recommendation 11 are not being fully complied with. Recommendations in relation to this are contained in the relevant sections of this Report.

14.3.8 **Business Awareness**

The BVI has already embarked upon a significant training programme, through the Educational Sub-Committee of JAMLCC. This is a positive step and we support the BVI's commitment to continuing and developing awareness. In particular the introduction of the Code of Practice will need to be supported by a full business awareness programme.

14.3.9 **Other regulations**

The lack of a regulatory system for securities and investment business may mean that persons who are not "fit and proper" can operate a financial institution. This is out of line with FATF Recommendation 29.

14.3.10 **Cross-border flows of funds**

As indicated, there are no direct measures to detect or monitor the cross-border transportation of cash and bearer instruments.

Whilst such a detection system is envisaged by FATF Recommendation 22, the Recommendation does not make the provision mandatory. We consider that the implementation of such a system is an option, rather than an international standard.

Nevertheless, we consider that the BVI should consider imposing a requirement upon its licensed banks and other relevant institutions to report cash flows to and from abroad, in accordance with FATF Recommendation 30 and CFATF Recommendation 15.

We welcome your comments on this site.

Prepared 27 October 2000

Appendix 1

PREAMBLE: REVIEW OF FINANCIAL REGULATION IN THE CARIBBEAN OVERSEAS TERRITORIES AND BERMUDA

The Overseas Territories' White Paper proposes establishing a renewed contract between the UK and the Overseas Territories (OTs). A modern and effective partnership should be built upon the foundations of responsibilities on both sides, coupled with the UK assisting the OTs where necessary, and the OTs exercising control over their own lives in a responsible way.

The UK is pledged to look after the OTs' interests internationally. This goes hand in hand with the OTs meeting accepted international standards, and playing a responsible role in the international community. In the area of offshore financial services, some of the OTs are significant players in their own right. The business conducted in offshore centres is often linked intrinsically with activities regulated in other countries, including the UK and our key international partners. The quality of regulation in the OTs has an indirect or direct effect on people, firms, and markets in other countries, as well as the international financial system.

The Terms of Reference provide for an indepth independent review by experts to assess progress made in the regulation of the offshore sector, and to make further recommendations on how to deal with outstanding issues. HMG circulated Guidance Notes to Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands which indicate accepted international standards and good practice in financial regulation. Following consultation with these OTS, the Guidance Notes and Terms of Reference for the review of financial regulation in the OTs have been revised.

2 September 1999

TERMS OF REFERENCE FOR THE REVIEW OF FINANCIAL REGULATION IN ANGUILLA, BERMUDA, BRITISH VIRGIN ISLANDS, CAYMAN ISLANDS, MONTSERRAT AND TURKS AND CAICOS ISLANDS

PURPOSE OF THE REVIEW

To assess Overseas Territories' (OTs) performance against international standards and good practice as set out broadly in the Guidance Notes[3].

To make recommendations for improvement where the OTs fall below these standards.

REGULATION OF FINANCIAL ACTIVITY

The review should list separately the type and composition of offshore financial services business in each OT ie. Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands. It should ascertain what legislation, regulations, rules, guidance, systems, and procedures (statutory or otherwise) govern the regulation and supervision of the:

- banking sector;

- insurance sector;

- securities sector, including mutual funds and stock exchanges.

This assessment should cover the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulation and laws.

The review should evaluate to what extent arrangements in the OTs meet standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to relevant standards provided by these bodies are broadly set out in the

Guidance Note covering this section. The review should consider the adequacy of the system of supervision relative to the objectives of an OT's financial services regulation. It should comment on the existence and adequacy of depositor and investment protection schemes. The review should determine whether further action is required by any territory in order to meet the standards broadly set out in the relevant Guidance Note, and prioritise recommendations.

REGULATION OF COMPANIES, PARTNERSHIPS, TRUSTS

The review should supply a breakdown of the type and composition of the company, partnership, and trust sectors in each OT, including company and trust service providers and formation agents, the involvement of professionals (accountants and lawyers), and the scale of activity. It should determine and assess the legislation, framework, systems, rules, regulations, guidance and procedures in place which provide for the regulation of activity in these sectors. The review should establish whether these arrangements conform to good practice and standards outlined in the relevant Guidance Note, which in turn refers to the principles set out in: the Basel Committee on Banking Supervision; International organisation of Securities Commissions (IOSCO); the Financial Action Task Force 40 Recommendations; Caribbean Financial Action Task Force Aruba Recommendations, the International Accounting Standards Committee, the G22 report on Transparency and Accountability (October 1998), IMF Guide to Progress in Strengthening the Global Financial Architecture (April 1999) and the OECD Principles of Corporate Governance.

The review should evaluate the appropriateness of the regulatory measures in place, including the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulations, and laws.

Furthermore, it should ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts. The review should detail the type of information available on the activities of company, partnership and trust. It should determine whether the mechanisms in place are sufficient. The review should also consider whether further action is required by any territory to meet the standards broadly set out in the Guidance Note, and prioritise recommendations.

INDEPENDENT REGULATORY AUTHORITIES

The review should evaluate to what extent regulatory authorities comply with accepted international standards advocated, principally, by Basel, IOSCO, OGBS and IAIS.

In particular, the review should evaluate whether regulatory authorities are accountable, independent and free from business and political influence, and properly staffed and budgeted for, with an independent source of income. It should determine whether the authority is detached from the marketing of financial services and where this is not so any impact this may have on the ability of the regulatory authority to regulate the sector objectively. The review should assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance, and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; cooperate with requests for assistance from foreign authorities and; enforce rules, regulations, laws by taking enforcement action, and the extent to which they can liaise with law enforcement authorities in the sharing of information. The review should consider which activities fall under the responsibility of the regulatory authority, and whether the regulatory net covers all financial activities. it should comment on the resources available to the authority, both for the purpose of recruitment, training and retention of staff and its infrastructure, such as the use of technology.

The review should consider what legal advice is available to the authority and its effectiveness in helping the OT government to regulate the sectors.

INTERNATIONAL COOPERATION

The review should evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of OT law enforcement and regulatory authorities to cooperate with requests for assistance from foreign authorities. The necessary requirements are broadly set out in the relevant Guidance Note. The review should ascertain what legal advice is available to OT regulatory and law enforcement authorities and its effectiveness in helping the OT government to co-operate in these areas. The review should determine whether further action is required by any territory in any of these areas, and the relative priority of such action.

<u>Cooperation between regulatory authorities</u>

The review should consider whether there are effective 'Gateways' provisions in place; OTs' powers to obtain information,

including by compulsion; ability of foreign authorities to take voluntary testimony from OT residents; an OT's ability to safeguard the confidentiality of information provided by foreign counterparts; provisions governing conditions under which information may be passed to overseas jurisdictions; whether effective Memoranda of Understanding exist, where required to underpin cooperation.

Cooperation between law enforcement authorities

The review should assess the extent of cooperation to which OT law enforcement authorities can obtain evidence on behalf of their foreign counterparts, and exercising other available mutual legal assistance powers, stating the mechanisms and OT authorities involved; an OT's ability to assist foreign authorities in tracing, freezing and confiscating proceeds in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (November 1990), even if the underlying conduct takes place outside the OT; the effectiveness of Mutual Legal Assistance Treaties with the USA where applicable, and the provision of basic statistics on the volume of requests for assistance made and received; powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted; ability to safeguard the confidentiality of information provided to OT authorities; whether effective Memoranda of Understanding exist, where required to underpin co-operation.

Cooperation between regulatory and law enforcement authorities

The review should evaluate whether there is effective cooperation

between law enforcement authorities and financial regulators, both domestically and abroad, as specified by the G7 key 10 principles. It should also consider the ability of OT regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

MEASURES TO COMBAT MONEY LAUNDERING

The review should establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the OT to combat money laundering, and types of offences caught by the legislation. It should determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.

The review should evaluate the effectiveness and adequacy of these arrangements, in terms of how they meet the standards broadly set out in the relevant Guidance Note, which in turn refers to: 1988 UN Drugs Convention; FATF 40 Recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990), and CFATF Aruba Recommendations. Furthermore, it should consider to what extent the OTs apply standards set out by the EC Money Laundering Directive (June 1991), the standards on which UK anti-money laundering legislation is based.

Specific consideration should be given to those offences considered predicate for the purposes of money laundering legislation; whether OTs have regulatory legislation in addition to the principle money laundering offences, and if not, whether guidelines and/or Codes of Practice exist (statutory or otherwise); their systems for reporting suspicious transactions and identifying customers; the institutions obliged to report; how reports are dealt with; and within what timeframe. The review should consider how this information is disseminated and shared with foreign counterparts. It should evaluate ability of Financial Intelligence Units (FIUs), or equivalents, to deal with suspicious transactions ie. whether staff have been properly trained and capable of conducting financial investigations and analysis; the resources at their disposal; feedback to the financial institutions.

The review should determine to what extent the AttorneyGeneral's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws. This not only relates to the prosecution of cases but the provision of assistance to foreign jurisdictions in pursuance of money laundering legislation.

FORMAT OF REPORT AND TIMESCALE

FCO, HM Treasury and OT representatives will wish to agree with KPMG the precise format of the report during Phase 1 of the workplan.

KPMG should provide written monthly reports to the Steering Committee (in electronic form) and attend Committee meetings at least during Phases 1, 2 and 5 (dates to be agreed).

10 December 1999

THE SUPERVISION OF THE BANKING, INSURANCE AND SECURITIES SECTORS

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories states that the Overseas Territories (OTs) should seek to implement "*legislation for the effective regulation of the offshore sector which fully meets accepted international standards*". In many cases the OTs have already implemented some of the standards, but no attempt is made here to analyse individual territories' performance to date. Such an analysis is the objective of the independent review foreseen in the White Paper, and to attempt it in the context of this paper would result in a superficial and incomplete impression of where matters stand. Instead, the purpose of this paper is to provide an overview of the framework within which international standards relating to the regulation of banking, insurance and securities business are established, and to offer an outline of the broad standards that have evolved. The paper is not intended to act as a substitute for the study of the detailed documents published by the respective standardsetting organisations, primarily the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to these documents can be found in the following text and, specifically, in publications available on the respective websites. The following are also key documents:

Core Principles for Effective Banking Supervision	Basel Committee	Sept 1997
The Supervision of CrossBorder Banking	Basel Committee	Oct 1996
Insurance Principles, Standards and Guidance Papers	IAIS	Oct 1998
Objectives and Principles of Securities Regulation	IOSCO	Sept 1998

THE OBJECTIVES OF SUPERVISION

2. The objectives of financial services supervision fall into four broad categories:

· to secure the appropriate degree of protection for consumers of financial services;

· to maintain confidence in the financial system;

· to promote public understanding of the financial system; and

· to reduce the scope for financial crime.

3. The protection of consumers' interests does not assume an absolute objective to prevent financial consumers from losing money, but rather to create an environment where financial risk is better understood, and where there is less chance of consumers taking unnecessary and excessive risks. As stated in a recent Occasional Paper published by the UK's Financial Services Authority, this process requires "*having regard to the differing degrees of risks involved in different kinds of investment, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions*"[4]. Delivery of the appropriate environment involves both proper transparency and disclosure by financial institutions, and the effective enforcement of laws, regulations and rules by the regulators.

4. Preservation of confidence in the financial system has at its core the need to mitigate the risk of systemic failure, or of the system falling into disrepute. This will not necessarily be focused on the narrow issue of whether individual depositors or investors are threatened with the loss of money, but on whether the system as a whole might be under threat from the failure of one or more institution. There are circumstances in which individual financial institutions can and should be allowed to fail without fear of a threat to the system, even though there might be losses for the customers of those institutions.

5. The rising tide of financial crime has increasingly posed threats to the integrity of financial systems. This impacts upon both the financial stability of institutions and upon the reputation of individual jurisdictions. Although financial services supervisors are not expected to police the wider criminal laws, it is clearly important for the supervisors to play their part in reducing the exposure of the financial services sector to criminal abuse, and in tackling financial crime and regulatory abuse. This requires OT regulatory authorities to have appropriate investigative powers and specialist enforcement branches, and to cooperate fully with the authorities in other jurisdictions. The responsibility for investigating individual cases of money laundering should, however, fall to OT law enforcement authorities.

THE SUPERVISORY FRAMEWORK

6. Perhaps the single most important aspect that underpins the integrity of the financial services sector is a longterm political

commitment to effective regulation and supervision. Without such commitment the regulators will always be starved of the tools needed to achieve an effective result.

7. Fundamental to this process is a willingness to enact comprehensive regulatory legislation, to develop the associated regulations, rules and guidance, and to keep this structure under review to ensure that it stays abreast of trends both in the financial services industry itself, and in the development of regulatory practices. While the individual techniques of supervision and enforcement may vary in order to address the respective distinctive features of the offshore and domestic sectors, the fundamental standards applied to the offshore sector should not differ from those expected for the domestic market. With regard to the offshore sector, it is essential that due regard is paid to the regulatory implications in tandem with any moves taken to facilitate the development of business. Moreover, there should be no attempt to encourage "regulatory arbitrage" by seeking to offer a lighter regulatory regime than exists in competitor jurisdictions.

8. A central part of the legal framework must be provision for an effective, operationally independent and accountable regulatory authority with the appropriate powers to fulfil the objectives identified in section 2. However, legal form alone is not sufficient to provide the basis for an effective regulatory system. There needs also to be an allocation of resources in line with the structure, scale and complexity of the financial services sector. This involves an acceptance of the need to invest in the staff and infrastructure of the regulatory authority in order to ensure that it has appropriate skills and tools to meet the tasks expected of it. It has also to be recognised that there can be no formalistic approach to the funding of the regulatory regime, based, for example, on the direct benefit derived by government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision. By entering the offshore market a jurisdiction has to accept that not only does it have a duty to preserve the reputation and standing of its own financial system, but that it also assumes a wider responsibility to the international community to help ensure the integrity of the global market.

THE DEVELOPMENT OF INTERNATIONAL STANDARDS

9. The increasing internationalisation of financial services in the past decade has led to a drive to establish some common minimum standards of supervision. The application of these standards is seen as particularly important in financial centres with a high proportion of international business, since the failure of supervision there may have far wider implications than simply for the local market.

10. Standards for the supervision of the banking sector have been developed over many years under the auspices of the Basel Committee on Banking Supervision which promulgated the first Basel Concordat in 1975. In recent years there has been a rapid increase in publications emanating from Basel, many of which are intended to represent accepted international standards. Although the Basel Committee is an organisation whose membership comprises the G10 countries, it has a number of "regional" affiliates, not least of all the Offshore Group of Banking Supervisors, which have been closely involved in the development of the standards in recent years. The list of publications produced by the Basel Committee is available on the website of the Bank for International Settlements (www.bis.org). In the context of this paper the most significant of the documents are *The Core Principles for Effective Banking Supervision* (published in September 1997), which delivers 25 basic principles, and *The Supervision of CrossBorder Banking* (published in October 1996), which contains 29 recommendations.

11. In the insurance sector standards are increasingly being established by the International Association of Insurance Supervisors (IAIS). The IAIS was established in 1992 and has membership of about 100 jurisdictions, including several offshore centres. Until 1996 it had no standardsetting powers, but since that time has produced a number of standards and guidance papers. These are consolidated within the *Insurance Principles, Standards and Guidance Papers* published in October 1998. The IAIS standards focus on particular supervisory issues, describing the best or most prudent practices, while the guidance papers are designed to assist regulators to raise the effectiveness of supervision. The IAIS is in the process of developing a website which should be available shortly.

12. The primary international standards body in the securities sector is the International Organisation of Securities Commissions (IOSCO). Like the Basel Committee, IOSCO has been working over many years and published its first *Resolution on the Regulation of Securities Markets* in 1983. Unlike Basel, its membership is big (over 90 countries) and includes a large number of emerging markets and offshore centres. IOSCO's bylaws include clear objectives, with which all members are expected to comply. They include the requirements for members to cooperate, to promote high standards of regulation, to apply the standards rigorously, to establish effective surveillance and enforcement, to maintain just, efficient and sound markets, and to exchange information. In September 1998 IOSCO published its *Objectives and Principles of Securities Regulation* which sets out the 30 Core Principles of securities regulation. In addition, IOSCO has over the years produced a substantial range of other documents which represent commitments by the membership, guidance or standards,

and which are available on its website (www.iosco.org).

13. Although membership of these standardsetting organisations, or their affiliates, has been open to offshore centres, acceptance of, and compliance with the principles that the organisations espouse are essential preconditions for membership.

OVERVIEW OF THE COMMON PRINCIPLES

14. It has to be reiterated that the documents referred to in this paper are essential reading, and it is not the intention of this paper to provide a substitute summary. However, in considering the structure of the overall regulatory regimes required in the OTs it is important to identify the common themes that underpin the regulation of all three sectors. This section seeks to highlight these themes. However, it is important to appreciate that, while there are common characteristics of the regulation of the different sectors of the financial services industry, different skills and processes will be required to effect proper regulation of each sector. The reference documents address these differences.

A. General Principles

a) Regulation should be vested in a properly constituted authority which should be operationally independent from political and commercial interference in the exercise of its functions. However, it should also be openly accountable in the exercise of its powers (see also the separate paper on *Independent Regulatory Authorities*).

b) The regulatory authority should have a clear, adequate, achievable and consistent framework of responsibilities, objectives and powers set by legislation, and it should adopt processes which are fair, consistent, transparent to the public, and demonstrably geared towards achieving the objectives.

c) The regulatory authority should have adequate funding to enable it to acquire the resources (staffing, technology, infrastructure etc) to fulfil its responsibilities. The funding should be available in such form that it does not compromise the authority's independence from both political and commercial pressures.

d) The regulatory authority should have due regard to the need to compete with the commercial sector for skilled staff, and should structure its terms and conditions of employment accordingly. It should also ensure that its staff receives ongoing training.

e) The system of supervision should involve both offsite surveillance and onsite examination. This requires the regulatory authority to have the powers not only to set the scope, content and frequency of routine reporting by regulated institutions, but also to have access, whenever it considers it appropriate, to the books, records, accounts and other documents maintained by the institutions. There should be no secrecy barriers to limit the regulators' access to information.

f) The regulatory laws should establish proper licensing standards and criteria, and the regulatory authority should adopt effective procedures to ensure that applications are reviewed in a thorough and consistent manner. As a minimum this should require the implementation of comprehensive due diligence procedures in relation to controllers, directors and managers of prospective licensees, and a detailed analysis of an applicant's business plan, internal controls, projected financial condition and likely ability to comply with established prudential standards.

g) The regulatory laws should provide for notification of any intended change in ownership or control of a regulated institution, and for such changes to be subject to prior approval by the regulatory authority.

h) The regulatory authority should have the powers to implement and enforce prudential standards both generally across the entire sector, and specifically in relation to individual institutions. For example, this requires that the authority adopt and enforce suitable standards for capital adequacy, solvency, liquidity, risk concentration, asset valuation etc, taking account of accepted international standards and guidelines.

i) The regulatory authority should require institutions to maintain minimum standards of corporate governance, internal controls and operational conduct with the aim of protecting the interests of clients, ensuring proper management of risk, and accepting primary responsibility for these matters. Careful attention should be paid, for example, to the role and responsibilities of the board of directors, the arrangements for delegating authority and responsibility, the separation of duties, the safeguarding of assets and the procedures for internal audit.

j) Regulated institutions should be required to maintain proper books, records and accounts.

k) There should be procedures for dealing with the failure of a market intermediary in order to minimise damage

and loss to financial consumers and to contain systemic risk.

1) The regulatory authority should be vested with comprehensive and credible inspection, investigation, surveillance, and enforcement powers, including

- powers to take action to ensure compliance with regulatory requirements;
- powers to impose administrative sanctions for noncompliance;
- powers to initiate or refer matters for criminal prosecution; and
- powers to suspend or revoke authorisation to conduct business.

m) Regulated institutions should be subject to independent external audit in accordance with international accounting standards, and should be required to disclose to the public information regarding their activities and financial position that is comprehensive and not misleading. This information should be sufficient for financial consumers and market participants to assess the risk inherent in individual institutions.

n) The establishment of trading systems, including securities exchanges, should be subject to regulatory authorisation and oversight. Trading should be supervised in a way which ensures that the integrity of the market is maintained. There should be fair and equitable rules which strike an appropriate balance between the demands of different market participants.

o) Market regulation should promote the transparency of trading, be designed to detect and deter manipulation and other unfair trading practices, and aim to ensure the proper management of large exposures, default risk, and market disruption.

p) Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and be designed to ensure that they are fair, effective and efficient, and reduce systemic risk.

q) The regulatory system should set appropriate standards for the eligibility and regulation of collective investment schemes; provide for rules governing their legal form and structure, and for the segregation and protection of client assets; require disclosure necessary for evaluating the suitability of a scheme for particular investors; and ensure that there is a proper and transparent basis for the pricing and redemption of units.

r) The regulatory authority should have the powers and procedures to ensure that regulated institutions take action to protect themselves against criminal misuse, and that they maintain appropriate systems to comply with anti-money laundering regulations.

B. Cross-Border Issues

a) The regulatory laws and supervisory policy and procedures of a jurisdiction should seek to ensure that no institution operating across national boundaries escapes supervision, and that the supervision should be effective. In this context attention should be paid not only to corporate structures that might frustrate effective consolidated supervision (e.g. parallel-owned entities), but also to arrangements where the physical location of the licensee's mind and management differs from that of the regulator (e.g. shell branches).

b) The creation of a crossborder establishment in the regulated sector should be subject to prior consultation and agreement between the home and host regulators. This is essential not only to ensure proper assessment of the application, but also to enable both parties to agree the necessary procedures for ongoing supervision of the institution.

c) The regulatory authority should be empowered to collect both public and nonpublic regulatory information, and to share this in accordance with international principles with domestic authorities and foreign counterparts. Co-operation in the exchange of such information involves exchanges of a routine nature and the provision of assistance in an enforcement investigation, as well as in the event of the emergence of serious problems (see also the separate paper on *International Cooperation*).

d) The regulatory authority should have the powers to assist an overseas regulator in the fulfilment of its functions. This may involve assistance in obtaining information or records, but will also extend to the use of investigative or compulsory powers on behalf of the overseas regulators. Secrecy or confidentiality provisions in the law of a

jurisdiction should not be used as a means of impeding such assistance.

e) There should be no barriers to prevent a home country regulator from undertaking such procedures, and having access to such information in the host country as it considers necessary to undertake the effective consolidated supervision of an international financial services group.

THE FUTURE DEVELOPMENT OF STANDARDS

15. The rate of development of internationally recognised and accepted regulatory standards has accelerated in recent years, and further announcements should now be expected on a regular basis. Therefore, it is important to appreciate that compliance with international standards is not a static or "oneoff" process, but will require regular updating of laws, policies and procedures. With this in mind, regulatory authorities in the OTs should continue to monitor international developments, particularly where they participate in or are affected by the work of one or more of the key international standardsetters mentioned above. They should, in particular, be prepared to recommend changes in legislation where appropriate, and to implement new procedures to ensure that compliance is kept up to date. This applies in all three of the main sectors referred to in this paper.

IMPLEMENTATION

16. Standardsetting is not, by itself, enough. It needs to be accompanied by active monitoring of compliance with these standards, and the commissioning of the independent review of the OTs must be seen in the wider context. The G7 report on *International Financial Architecture*, agreed at Cologne, said:

"*With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation*."

17. The standardsetting regulatory bodies the Basel Committee, IOSCO and IAIS are now working increasingly closely with the IMF and the World Bank. In the field of banking supervision, for example, the Basel Committee, the IMF and the World Bank, working with selected supervisors around the world, have developed a *Core Principles Methodology* text which provides detailed guidance to the IMF and World Bank for their assessments of compliance. It is expected that such assessments will be made for an increasing number of countries and territories around the world; and that the results of such assessments will be used by regulators (see for instance the Basel Committee's consultative paper on a *New Capital Adequacy Framework*) and by the Washington institutions (as a precondition in the IMF's new Contingency Credit Line).

18. An IOSCO Implementation Committee, in which the IMF, World Bank and the regional development banks participate, has been set up to oversee the implementation by IOSCO members of the 30 Core Principles. Cooperation between IOSCO and the international financial institutions is at the heart of this process.

COMPANIES AND TRUSTS

1. There are legitimate reasons for using company and trust vehicles. However, the White Paper "Partnership for Prosperity" (Appendix 2, paragraph 4) states "We shall also press Overseas Territory governments to introduce legislation to improve regulation of company formation and management because, for example, in the absence of proper regulation, complex company structures can be used to disguise the proceeds of crime and other regulatory abuse as well as providing limited liability." The White Paper continues "Company formation agents and company managers need to be required by law to hold key information about the companies for which they have responsibility and to disclose that information to a regulator on request. This will ensure a properly documented paper trail for criminal and regulatory investigations."

2. This paper considers the issues of company and trust regulation relevant to the regulation of the financial system. The paper does not set out a blue-print for Company and Trust Law and regulation as a whole - that would be outside the scope of the Review, and constitute a major undertaking in its own right. The two sectors - companies and trusts - fulfil very different purposes, and their regulatory regimes have evolved in different ways, to meet different objectives. Nevertheless, in respect of their potential as vehicles for abuse, the issues raised by the trust and company sector are similar, and for this reason, this paper treats them in parallel. But the Review may wish to consider them as distinct sectors.

4. The opportunities for companies and trusts to be used for criminal purposes cannot be removed. Effective regulation can help reduce the scope for criminal abuse of such vehicles. There is no single international group of company and trust regulators. Nevertheless, the regulatory principles established by other international bodies in relation to other financial sectors apply equally well to the company and trust sectors:

The principle that financial institutions should know their customers (established by - among others - the Basle and IOSCO

standards) applies with particular relevance to situations in which the ownership of assets may be obscured through company and trust vehicles;

FATF Recommendation 11 requires financial institutions "*to take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located)*". The interpretative note to this recommendation states "*a bank or other financial institution should know the identity of its customers, even if these are represented by lawyers....accordingly, recommendation 11 also applies to the situation where an attorney is acting as an intermediary for financial services*". This accepted international standard implies that financial institutions should be able to delve beneath a corporate or trust structure, to establish the true beneficial owner and other relevant parties, and not simply the name of a lawyer acting as an intermediary.

The FATF's Recommendation 25 states "*Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities*";

International standards on accounting, disclosure and auditing practice; covering timeliness in the provision of financial information, completeness, consistency, risk management, audit and control. The relevant standards include those set by the International Accounting Standards Committee; the G22 report on transparency and accountability, October 1998; and the IMF *Guide to Progress in Strengthening the Global Financial Architecture*, April 1999). These standards are particularly relevant when there are obligations to third parties arising;

Standards of corporate governance, reflected in the *OECD Principles of Corporate Governance*, which OECD members, in co-operation with the World Bank and IMF, are committed to promoting amongst non-member countries;

The Home Office report on "*Financial Regulation in the Crown Dependencies*" (The "Edwards Report") makes specific recommendations, based on the internationally accepted principles outlined above, for the company and trust sectors of the Isle of Man, Guernsey and Jersey.

5. Satisfying these principles implies the following;

(i) Beneficial ownership.

It should be possible for law enforcement and regulatory authorities to ascertain, quickly and efficiently, and in advance of formal proceedings, the true owner of assets held by a company or trust, and the source and nature of financial transactions. It is essential to be able to trace the ultimate individual beneficial ownership of companies and to get beyond elaborate structures in which companies are owned by layers of other companies and/or trusts, which obscures the ultimate owner.

In the company sector, this would involve the OT authorities having the means to identify company directors and the beneficial ownership of shares, eg where nominees exist. Effective custody arrangements would need to be in place in relation to bearer shares. In the trust sector, OT authorities should have the means to be able to identify the settlor, the beneficiaries, the trustees, the protector, and the custodian, where applicable, and should be able to obtain a copy of the trust instrument. This would help identify 'sham' trusts, for example. OT authorities should have the means to obtain up-to-date information, and to obtain such information in relation to companies and trusts which might be established in other jurisdictions, yet which might be managed or move to the OT concerned.

(ii) Anti-money laundering systems.

Intermediaries providing corporate or trust services should have in place effective anti-money laundering measures, including "know your customer", record keeping, and staff training requirements. Suspicious transactions involving companies and trusts should be disclosed to a Financial Intelligence Units. (More details on anti-money laundering standards are set out in the 'Money Laundering Guidance Note').

(iii) Transparency of financial arrangements.

Basic financial information relevant to the activities of companies and trusts should be available, quickly and efficiently, and in advance of formal proceedings, to law enforcement and regulatory authorities. Ideally, such information in the company sector should also be available to customers, shareholders, suppliers and lenders, where appropriate. In the trust sector, trustees should ideally be held accountable to the beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector where applicable.

The Review will wish to consider in which circumstances it would be appropriate to require accounts to be produced, in which circumstances such accounts should be made public, in which circumstances abbreviated accounts might be acceptable, and in which circumstances the requirement to produce accounts should not be applied. The latter might apply where single asset holding vehicles exist with no third party involvement.

(iv) Obligations on directors, trustees, and company and trust service providers.

Measures should be in place to ensure that directors and trustees fulfil their "due diligence" obligations effectively, and to prevent nominees from assigning their responsibilities to others through general powers of attorney, and being used as a cover for criminal activities and regulatory breaches. More generally, those who provide corporate and trust services should be licensed, and subject to effective regulation. The "four eyes" principle should apply. The codes which apply to company and trust managers should be complementary, for example to avoid a situation in which inter-linking ownership of company and trust vehicles can be used to obscure beneficial ownership. OT authorities should be able to identify the true directors and owners of a company, and the settlors, beneficiaries, trustees, protectors, and custodians of a trust. The rules, regulations, and laws relating to insolvency and bankruptcy should also be examined by the Review, to ensure that these may not be abused, eg for the purpose of defrauding shareholders.

(v) Investigative and enforcement powers.

OT authorities should be able to apply full investigative powers to those (eg directors, beneficial owners, settlors, beneficiaries, trustees, nominees) who are suspected of criminal activity. This extends to applying the compulsory powers referred to in the paper on 'International Co-operation'. OT authorities should be able to identify the links which may exist between companies and trusts. OT authorities should launch appropriate investigations in the face of bankruptcy and insolvency. More generally, the regulation of company and trust service providers and formation agents needs to be accompanied by effective and independent enforcement powers, including the power to monitor and supervise licensed formation agents and service providers, to inspect their activities, to investigate potential breaches of rules, regulations, and laws, and to take appropriate enforcement action. The latter would include the ability and willingness to take disciplinary action (eg remove licences) as well as to pursue civil and criminal sanctions.

(vi) Removal of impediments to asset tracing and seizure.

Trust and company arrangements should not be able to be used to frustrate the due process of law in attempts to trace and seize assets.

INDEPENDENT REGULATORY AUTHORITIES

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories explains that one of the "key components of the regulatory package we wish to see in place by the end of 1999" is "the establishment of independent regulatory authorities meeting accepted international standards". The Financial regulation checklist appended to the White Paper provides further detail on what this amounts to.

2. Four publicly available papers provide more specific details on what the international community expects from a regulatory authority. These documents are (i) "Objectives and Principles of Securities Regulation" by the International Organisation of Securities Commissions; (ii) "Core Principles for Effective Banking Supervision" by the Basle Committee on Banking Supervision; (ii) "The Supervision of Cross-Border Banking" by the Basle Committee on Banking Supervision and the Offshore Group of Banking Supervisors; (iv) "Insurance Principles, Standards and Guidance Papers" by the International Association of Insurance Supervisors.

KEY FEATURES

(i) Independence

3. Independence is required in order to generate confidence, in particular that all market participants will be treated objectively and fairly, and that rules and regulations will be applied uniformly in such a way as to protect investors and promote orderly market activity. These objectives will not be satisfied unless the regulatory authority is clearly seen to act independently, and to have sole responsibility for regulating market activity.

4. The concept of independence does not imply that regulatory authorities are unaccountable. Instead, it implies that their

day to day operations should be free from political or commercial control and influence. These executive operations include all the regulator's key functions, such as (a) deciding to issue, suspend, and withdraw licences; (b) supervising and inspecting the activities of licence holders, including issuing rules and regulations; (c) undertaking investigations; (d) taking enforcement action, and; (e) co-operating with overseas authorities. The regulatory authority should have the necessary powers and ability to regulate all licensed activity.

5. Proper independence requires the regulatory authority to exist as a stand-alone body, rather than as eg a separate unit within the Finance Ministry. Independent regulatory authorities are typically established by statute, which sets out the authority's powers and responsibilities. Those working in the authority, including senior management, should not have any external commercial or political interests or responsibilities (including unpaid directorships). The regulatory authority should not be required to secure OT government approval before exercising its executive powers.

6. Independence extends to the authority's functions. The regulatory authority should not be charged with any political or commercial responsibilities. In particular, the authority should not seek to market its jurisdiction as a place for business to locate. All such hard selling and marketing should be undertaken by a separate body which is not connected in any way with the regulatory authority (again, members of staff should not work in both bodies). Such separate promotional bodies should not be funded by the regulatory authority. Essentially, the job of selling the merits of doing business in a particular OT should be left either to OT governments or to the private sector. It would, however, be open to the regulatory authority to provide information about the regulatory regime in the jurisdiction to potential inward investors.

7. Independence extends to the way in which the authority is resourced. Regulatory authorities should be self-supporting and have their own source of income, independent from Government control. This is often raised through licence fees or another form of industry levy. Where these fees currently account for a large proportion of OT government income, the authority would return any excess income to the government.

8. Independence does not imply isolation. The regulatory authority should consult both the industry and the OT government before seeking to make any changes to broad regulatory policy, and before seeking to make changes which have national policy implications, or which have significant implications for the industry. These implications can properly include considerations of internal and external competitiveness, within the parameters of relevant international standards.

(ii) Accountability

9. Independent regulatory authorities are subject to a number of checks and balances, which in turn ensure that they are held accountable for their actions. In particular;

(a) Statutory objectives. The objectives of the authority should be laid down by statute drawn up by the OT Government. These objectives should reflect the need to satisfy internationally accepted standards of regulation.

(b) Appointments. The authority should operate under a properly constituted board or Commission, which holds a mix of relevant expertise. All board/Commission members should be appointed on the basis of that expertise by the OT Government, or by the Governor in consultation with the OT Government (eg where the Governor retains responsibility for the offshore sector). All key policy decisions should be approved by the board.

(c) Legislation. Legislation covering financial regulation as a whole will often need to be amended or introduced in order to make any significant changes to the regulatory regime. Regulatory authorities do not normally have the power to make such legislation, and will need the support of those who do if significant changes are to be made to the regulatory regime.

(d) Annual report. The authority should produce an annual report available to the public explaining its operations over the past year, how its objectives have been tackled, how resources have been allocated, and how it intends to tackle its objectives in future. This would include publishing a set of audited accounts and possibly a Statement of Principles. The annual report should identify where problems have been encountered in meeting international standards, and how the authority intends to deal with these problems. OT Governments should question the authority in relation to its annual report.

(iii) Functions and powers

10. The documents mentioned in paragraph 2 provide full detail on the types of function expected of a regulatory authority. For the purposes of this paper, it is worth noting simply that the regulatory authority should have sole responsibility and powers in the following areas. These functions relate to the regulation of activity;

(a) Licensing. The regulatory authority should have sole responsibility for issuing, suspending, and withdrawing licences. This extends to having the powers and ability to investigate whether persons are 'fit and proper' to work for a licensed firm.

(b) Determining how licensed firms and persons should conduct business. The regulatory authority should have sole responsibility for setting conduct of business rules and regulations, and providing guidance for market practitioners. Where legislation is required, the authority should be able to make proposals to OT governments.

(c) Supervising and monitoring licensed activity. The regulatory authority should monitor all licensed activity. This would involve establishing regular (eg quarterly) reporting systems plus a programme of regular and 'surprise' inspections. The regulatory authority should not require the prior approval of any external body before conducting such inspections.

(d) Investigating. The regulatory authority should conduct in-depth investigations into suspected breaches of rules, regulations, and laws. The regulatory authority should have the power to compel the production of information from both licensed and unlicensed firms and persons, in the ways outlined in the paper on 'International Co-operation'. In particular, the regulatory authority should not pursue criminal investigations outside the regulatory function - the law enforcement authorities should be responsible for leading those investigations.

(e) Taking enforcement action. The regulatory authority should have the powers to take appropriate enforcement action in response to breaches of rules, regulations, and laws. This would include the ability to suspend and withdraw licences, the ability to issue directions, and the ability to levy fines. Where criminal activity is encountered, lead responsibility for taking enforcement action would normally fall to the law enforcement authorities in conjunction with the prosecuting authorities.

(f) Co-operating with other authorities. Where serious breaches are encountered, the regulatory authority would be expected to co-operate fully with other authorities within the OT, such as prosecuting and law enforcement authorities. This would essentially involve the regulatory authority handing over information it had obtained before it became clear that criminal activity was at hand, rather than the regulatory authority undertaking any criminal investigations. OT authorities should also co-operate fully with authorities based overseas, in the ways outlined in the paper on 'International Co-operation'.

(iv) Resources

11. The regulatory authority should be properly resourced in order to meet these responsibilities effectively, and a certain critical mass is required. This includes having access to legal and accountancy advice from sources which do not suffer from a conflict of interest. Regulatory authorities should have their own source of stable ring-fenced income, independent from Government or other political control and influence. This income is often raised from the industry in some way.

12. As stated in the paper 'The Supervision of the Banking, Insurance, and Securities Sectors', resources should be allocated 'in line with the structure, scale, and complexity of activity. The funding of the regulatory regime should not be based on the direct benefit derived by the OT Government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision'.

(v) Liabilities

13. Regulatory authorities are normally subject to statutory immunity from prosecution, in order to allow them to conduct their regulatory functions more effectively. Other jurisdictions are more likely to recognise this immunity if the regulatory authority matches up to international standards, in the ways outlined above. The converse is also true.

14. Properly resourced regulatory authorities which perform their functions in the ways envisaged by the documents mentioned in paragraph 2 are also much less likely to get into the sorts of situation where their actions might be subject to legal challenge. For example, the regulatory authority should be able to demonstrate that any problems did not arise as a result of substandard regulation.

INTERNATIONAL CO-OPERATION

INTRODUCTION

1. By their very nature, offshore centres conduct business which is linked with that in other financial centres. For this reason, it is important that offshore centres cooperate fully with requests for assistance from authorities in other jurisdictions. This includes both regulatory and law enforcement authorities. The types of assistance referred to in this paper do not include co-operation relating to fiscal matters.

2. The White Paper on Britain and the Overseas Territories explains that one of "the key components of the regulatory package we wish to see in place by the end of 1999" is "powers to ensure that, whatever the secrecy laws, regulators and law enforcement in those Overseas Territories with financial sectors can cooperate properly with their overseas counterparts, including on investigation and enforcement matters".

3. Assistance should extend to;

(i) Regulatory authorities sharing confidential regulatory information held on file or obtainable from licensed bodies.

(ii) Regulatory authorities obtaining information by compulsion from unlicensed bodies, and obtaining client information by compulsion from licensed bodies (where clients refuse to disclose this information voluntarily).

(iii) All such exchanges of information between regulatory authorities to take place under cover of a bilateral Memorandum of Understanding signed by each party, setting out the terms and conditions of assistance, including that the confidentiality of information provided must be safeguarded.

(iv) Law enforcement authorities providing assistance to their foreign counterparts covering all financial crimes (not just those related to money laundering or drugs-related offences), extending to investigative assistance before court proceedings have been issued, and providing for evidence to be obtained on their behalf.

(v) OT regulatory authorities allowing information disclosed to a foreign regulatory authority to be disclosed in turn by them to a foreign law enforcement authority, but only with the OT's prior consent, which may extend to placing conditions on how that information might be used.

GATEWAYS: A PRECONDITION FOR INFORMATION EXCHANGE

4. Where confidential information is exchanged with a foreign authority, or between different authorities within the same jurisdiction, confidentiality should be safeguarded. Confidential information should only be exchanged where provided for in law. Confidential information should only be passed to *bona fide* authorities which can safeguard its confidentiality, and these safeguards should be established in law. Similarly, legislation in Overseas Territories should provide OT authorities with the power to safeguard the confidentiality of information they may have received from foreign authorities.

5. All Overseas Territories should have in place statutory 'gateways' which enable confidential information to be exchanged with foreign authorities. This would include all forms of information of interest to the authorities, including information relating to individuals, bank accounts, trusts, and companies. 'Gateways' legislation should override any secrecy and confidentiality provisions in OT law, to the extent that it should allow confidential information from all sources to be passed to a foreign authority, as long as that authority could in turn safeguard its confidentiality.

6. It is possible that foreign regulatory authorities might be compelled by Court order in their country to disclose confidential information obtained from an OT authority. In these circumstances, the OT authority's prior consent should be sought before any confidential information is disclosed to the Court. If such consent is not forthcoming, the Court should be made aware by the foreign authority that any compulsion to disclose may damage relations between regulatory authorities, to the detriment of future regulatory co-operation, and that this would not be in the public interest.

CO-OPERATION BETWEEN REGULATORY AUTHORITIES

(i) Types of co-operatio

7. Gateways *per se* do not provide for adequate co-operation. They simply allow confidential information to be exchanged. Gateways need to be supplemented by powers which enable OT authorities to obtain information (either for their own purposes, or on behalf of foreign authorities), and subsequently to exchange this with foreign authorities.

(i) Supervisory information

8. OT regulatory authorities should be able to obtain, in the course of their normal duties, information relating to the supervision of licensed firms and persons. OT regulatory authorities should be able to exchange this information with their foreign counterparts.

(ii) Voluntary testimony

9. Representatives from a foreign regulatory authority should be allowed to visit an OT with the consent of the OT regulator, and take testimony from individuals and firms who voluntarily consent to being questioned by a foreign regulatory authority. Before approving a request to take voluntary testimony, the OT regulator should be satisfied (i) that the request comes from a *bona fide* foreign regulatory authority, and relates to their regulatory responsibilities, (ii) that the request relates to a specific line of investigation, and (iii) that the confidentiality of any information provided will be safeguarded.

(iii) 'Compulsory' powers

10. These are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT. Following discussions at the past three Attorney Generals' Conferences, a draft Model Ordinance providing for compulsory powers is now well developed (attached at Annex B).

11. Annex A provides more details on how these powers would operate in practice. Because individuals and firms are *compelled* to provide information, there are tight constraints and conditions on the use of these powers, and OT regulatory authorities would have discretion in deciding whether to use them on behalf of an overseas authority. It is worth noting here that;

> (i) Compulsory powers should only be used in certain specific circumstances. Incoming requests for information, which will require the use of OT compulsory powers to obtain it, should be vetted by the regulatory authority's lawyers (or an OT Magistrate/Court) within a specific time frame, in order to verify that compulsory powers may be used. Information obtained by compulsion may also be vetted by the regulatory authority's lawyers before final disclosure to a foreign authority;
>
> (ii) Information obtained by compulsion should not be used as evidence against the provider in any subsequent criminal proceedings. The OTs will wish to decide whether to preclude it being used as criminal evidence against third parties;
>
> (iii) Compulsory powers are used only at the very early stages of an investigation, when the investigator does not know whether criminal activity is at hand. Compulsory powers should no longer be used if/when it becomes clear that only criminal activity is involved, and hence that the investigation should be taken forward by the law enforcement authorities (once a suitable request for assistance has been made through other channels);
>
> (iv) Strict terms and conditions on the use of compulsory powers should ensure that they cannot be abused to go on 'fishing trips', that the Overseas Territories retain discretion over their usage, and that they should not be used when it would be more appropriate to go though other channels (eg Mutual Legal Assistance Treaties (MLATs)).

12. Subject to these conditions, information obtained by compulsion may be disclosed to the law enforcement authorities, who as a result may seek to obtain criminal evidence (via other channels). Information obtained by compulsion may help indicate where criminal evidence may be obtained, ie may lay the ground for further requests for assistance via other channels by foreign law enforcement authorities.

13. In summary, these powers are used to uncover facts during the very early stages of an investigation, before it is clear what has taken place, in order to gain a picture of what happened. When it has become clear what happened, the authorities may choose whether to take no action, whether to take disciplinary action, whether to consider civil proceedings, or whether to consider criminal proceedings. Criminal evidence would need to be obtained via other channels (ie agreements between law enforcement authorities) in order to pursue a criminal prosecution. In the UK's experience, compulsory powers are rarely used on behalf of a foreign authority (about ten times per year).

(ii) Memoranda of Understanding

14. It is common practice between regulatory authorities for the terms and conditions of information exchange and

investigative assistance to be set out in a Memorandum of Understanding signed between the authorities which will be co-operating with each other. Memoranda of Understanding usually require requests for assistance to be framed in terms of the specific activities which are being investigated by the foreign jurisdiction - eg they can prevent authorities going on 'fishing trips' in another jurisdiction.

15. Memoranda of Understanding should only provide for the exchange of confidential information when the foreign regulatory authority has demonstrated that they will be able to safeguard the confidentiality of information provided by the OT regulator. Memoranda of Understanding should specify explicitly how confidentiality will be safeguarded, and should set out the terms and conditions of onward disclosure, eg to a foreign law enforcement authority. It is common to allow a foreign regulatory authority to disclose information obtained (eg from an OT regulator) to another foreign authority, but only with the consent of the OT regulator in this example. Memoranda of Understanding should specify what terms and conditions apply to the use of compulsory powers, and this may include specifying how information provided may be used.

16. Memoranda of Understanding are not legally binding documents, nor are they any form of legislation. They are simply an agreement between two regulatory authorities. For this reason, they tend to be tailored to the degree and nature of assistance available in each jurisdiction. Separate MoUs tend to apply to each sector (ie banking, securities, and insurance), although eg an MoU in the securities field would still provide for the exchange of information on bank account details (where this was connected to a breach of regulations or laws concerning securities).

17. Further precise details on international standards relating to Memoranda of Understanding are set out in publications by the Basle Committee, IOSCO, and the IAIS. The IAIS paper 'Insurance Principles, Standards, and Guidance Papers' includes in an Annex a model MoU in the field of insurance. IOSCO have published separate guidance titled 'Principles for Memoranda of Understanding'.

18. An Overseas Territory regulatory authority may still exchange information with a foreign authority if a Memorandum of Understanding is not in place. The terms and conditions of such exchange would need to be agreed on a case by case basis. Memoranda of Understanding essentially provide a framework which allows information to be exchanged without the terms and conditions of such exchange having to be negotiated on each separate occasion. Memoranda of Understanding are therefore more relevant between jurisdictions which exchange regulatory information regularly.

CO-OPERATION BETWEEN LAW ENFORCEMENT AUTHORITIES

(i) Types of co-operation

19. Assistance should be available to foreign law enforcement authorities in relation to all forms of financial crime, rather than just drugs-related offences or money laundering. This would include fraud, insider-dealing, and market manipulation. An OT should be able to provide assistance even though the activity under investigation might not be a criminal offence in that OT. In these circumstances, OT law enforcement authorities will wish to consider whether there is a good reason to provide assistance, or whether it would be in the public interest not to provide assistance.

20. OT law enforcement authorities should be able to provide investigative assistance, and should be able to obtain evidence on behalf of their foreign counterparts. As with regulatory co-operation, assistance should be provided in response to specific requests. Investigative assistance should be made available before court proceedings have been issued, and ideally without the prior need for a Treaty to exist between the countries in question.

21. These objectives would be satisfied if the Overseas Territories were to adopt measures equivalent to those in the UK's Criminal Justice (International Co-operation) Act 1990, which provides for UK authorities to co-operate with judicial and prosecuting authorities in other countries in criminal proceedings and investigations. Many OTs have already introduced equivalent legislation. It is for OTs to decide whether they wish to satisfy the objectives specified here by adopting equivalent legislation or by choosing other means. It is worth noting here that assistance should be available to all *bona fide* foreign law enforcement authorities with genuine requests.

22. It is not common for Memoranda of Understanding to be signed between law enforcement authorities, if only because the types of co-operation required are often provided for by international Treaties. Nevertheless, there is nothing to prevent Memoranda of Understanding from being adopted, especially if OT law enforcement authorities wish to adopt bilateral agreements specifying exactly how assistance might be provided.

23. Memoranda of Understanding are generally easier and quicker to devise and modify than bilateral Treaties. For this reason, an OT is unlikely to be able to co-operate effectively in the ways envisaged with a wide range of countries over a wide range of areas if it seeks to negotiate, sign, and manage a set of bilateral Treaties with all foreign law enforcement

authorities which seek assistance.

(ii) Seizing assets

24. International co-operation should extend to tracing, freezing, and confiscating the proceeds of crime, and their value, on behalf of overseas authorities. Powers to trace assets for authorities in other jurisdictions should be exercisable regardless of banking secrecy and, preferably, on an agency to agency basis as well as through central authority channels. Powers to restrain and confiscate assets which represent the proceeds of crime should be on an all crimes basis, as envisaged in the 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime.

25. No assets should be immune from seizure, either by virtue of OT laws or other arrangements providing for asset protection, or by virtue of arrangements (eg in trust instruments) which require assets to 'flee' to another jurisdiction when there is a chance that they might be seized. These arrangements for asset seizure should apply to all financial crimes, ie not just drugs-related crimes or money-laundering, even though a crime may not have been committed in an OT.

CO-OPERATION BETWEEN DIFFERENT TYPES OF AUTHORITY

26. The G7 have recently adopted a set of ten principles concerning the extent to which regulatory and law enforcement authorities should work with each other, including when different types of authority are based in different jurisdictions. In general, different types of authority (regulatory and law enforcement) should be able to exchange information with each other and to provide each other with investigative assistance, subject to specific terms and conditions set out in Memoranda of Understanding. This does not imply that regulatory authorities should take on the role of 'international tax policemen'.

27. In practice, an OT regulatory authority would assist a foreign law enforcement authority by passing information to a foreign regulatory authority, and allowing them (with prior consent) to disclose this to a law enforcement authority in their jurisdiction. Domestic regulatory authorities do not tend to deal directly with foreign law enforcement authorities. If this arrangement is to work effectively, there need to be effective gateways and working relations between regulatory and law enforcement authorities in the same jurisdiction.

28. This should not, however, prevent OT regulatory authorities from dealing directly with foreign regulatory authorities which also happen to possess certain law enforcement and prosecuting responsibilities. In this instance, the Memorandum of Understanding between respective regulatory authorities would need to specify clearly how any information disclosed might be used.

ANNEX A: COMPULSORY POWERS (OR INVESTIGATIVE POWERS)

A1. Compulsory powers are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. In the context of regulatory co-operation, OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT.

A2. Compulsory powers may be used to obtain information from both licensed and unlicensed firms and persons. This includes ordinary members of the public as well as all financial institutions, companies, and trusts. Compulsory powers may be used to obtain all types of information, including details of beneficial ownership, personal bank details, and personal telephone records.

A3. Compulsory powers override all other secrecy and confidentiality provisions in law - ie they may be used to obtain information from bank accounts, companies, and trusts, even if other laws declare that all such information should not be disclosed. Confidential information would only be disclosed to a foreign regulatory authority if they could safeguard its confidentiality.

Use of compulsory powers

A4. These wide-ranging powers are used at the very early stages of an investigation to gain an understanding of what happened - ie which activities took place where, and who was involved with what. Compulsory powers are used infrequently, as regulatory authorities normally have a clear understanding of what happened, especially where 'know your customer' guidance is actively implemented and licensed firms and persons are willing to assist the authorities.

A5. Compulsory powers are used to undertake fact finding investigations, rather than to obtain criminal evidence. Information obtained by compulsion may be used by the regulator to take disciplinary or civil action. Because information is obtained by compulsion, it cannot be used as evidence in criminal proceedings against the provider.

A6. Furthermore, the 'rules of evidence' which exist in most countries normally prescribe how evidence may be obtained, and this tends to involve questioning under police caution: ie the very nature of compulsory powers normally prevents any information obtained from being used as evidence in criminal proceedings. OT regulatory authorities may in addition wish to specify in Memoranda of Understanding signed with foreign counterparts that information obtained by compulsion cannot be used as evidence in criminal proceedings.

A7. Compulsory powers should not be used to provide assistance to a foreign regulatory authority if it would be more appropriate to use other channels (eg Mutual Legal Assistance Treaties (MLATs)). It is for the requested authority to determine the appropriate channels in line with commitments entered into in any MoUs or Treaties. In practice, compulsory powers should only be used when it remains possible that civil action may be taken as a result of the investigation at hand. As soon as it becomes clear during the investigation that the authorities are faced with only criminal activity, compulsory powers should no be longer used. At this stage, the law enforcement authorities should be left to pursue a criminal investigation (and overseas law enforcement authorities should seek assistance via other channels).

A8. Within this framework, compulsory powers can still be used to assist law enforcement authorities, but only at the very early stages of an inquiry, when it remains unclear what happened, and hence whether civil or criminal sanctions (or none) would be appropriate. Information obtained by compulsion essentially lays the ground for criminal investigations undertaken by law enforcement authorities, should it transpire that criminal activity is at hand. Compulsory powers would be used before a foreign law enforcement authority is in a position to make a request for assistance from an OT law enforcement authority (eg via MLAT).

A9. In this limited sense, the use of compulsory powers may lead to criminal prosecutions. In practice, an OT regulatory authority would not deal directly with a foreign law enforcement authority. Instead, OT regulatory authorities would deal with their foreign counterparts, and then allow (with prior consent) their foreign counterparts to disclose information received to foreign law enforcement authorities.

Who investigates?

A10. Investigations are usually undertaken by the domestic regulatory authority on behalf of the overseas regulator. It is normal for these powers to be vested with the head of the regulatory authority, although an alternative may be to vest them with the Governor or Minister of Finance (depending on who is ultimately responsible for regulation of the offshore sector).

A11. Whoever holds these powers may authorise an officer of his or any other competent person to exercise them. If an OT so wishes, it is possible for an OT regulator to allow an overseas regulator to operate as an authorised agent of theirs and use these powers directly. The decision on who to appoint is normally made on a case by case basis.

A12. Payment of the costs of exercising these powers can be made a condition for providing assistance. This normally happens when the balance of requests tends to be one-sided, rather than domestic and overseas authorities seeking broadly equivalent assistance from each other.

Constraints and discretion in exercising compulsory powers

A13. The exercise of investigative powers after a request is not inevitable, nor is the disclosure of information obtained by their exercise. The powers can only be used to assist an overseas authority having specified regulatory functions, and then only for the purposes of those functions. Assistance should be provided when there is a good reason to do so (this hurdle is normally relatively easy to satisfy).

A14. The information which is obtained through the exercise of investigative powers can be disclosed only if a gateway exists. If there are concerns about how the confidentiality of the information provided will be safeguarded once in the hands of the overseas regulator, or if, as a result of the investigation, doubts have arisen about the authenticity of the overseas regulator's claim to need the information for its regulatory functions, the OT regulatory authority should discuss its concerns with the foreign regulatory authority before disclosing any information.

A15. Assistance should be provided in response to individual requests, which should specify what information is sought and the purpose for which it is sought, including details of the laws, rules or regulations which it is alleged have been breached and of the conduct which gives rise to the breach. The draft model OT Compulsory Powers Ordinance (attached) requires that the following factors be taken into account when deciding whether to exercise compulsory powers on behalf of a foreign authority;

Whether corresponding assistance would be given to the OT;

Whether the inquiries relate to a breach of law which has no parallel in the OT (although assistance may still be provided in these circumstances, if there is a good reason to do so);

The seriousness of the matter in question, the importance to the investigation of exercising compulsory powers, and whether assistance could be obtained by other means (eg MLATs);

Whether it is in the public interest to provide assistance.

A16. Each request for assistance should be vetted by the OT regulatory authority to ensure that it is made by a foreign authority which has the necessary functions and that the request is made for the purpose of its regulatory functions. The requesting authority must demonstrate that a substantial line of enquiry is being pursued - its request should not be a "fishing trip" for information. In practice, the OT regulatory authority would also vet all information obtained by compulsion, to ensure that information disclosed to a foreign authority relates to the specific request made. This vetting would normally be undertaken by the OT regulatory authority's legal advisers. The draft model OT Compulsory Powers Ordinance also provides for an OT Magistrate or Court to approve the use of compulsion, within a short time frame. Under the draft model OT Compulsory Powers Ordinance, it is a criminal offence not to provide information under the exercise of compulsory powers.

ANNEX B: DRAFT COMPULSORY POWERS MODEL ORDINANCE

A Bill entitled:

An Ordinance to make provision for assisting overseas regulatory authorities to obtain information:

ENACTED BY the Legislature of [the Caribbean Overseas Territory] as follows:

1. This Ordinance may be cited as the ******** Ordinance, 1998.

2. In this Ordinance:

"competent authority" means any authority specified in [the Schedule to this Ordinance] [an Order made by the Governor];

["Director" means the Director of Financial Services;]

"foreign regulatory authority" means an authority which, in a country or territory outside [the Caribbean Overseas Territory], exercises functions corresponding to any functions of a competent authority under any Ordinance, or exercises any function [prescribed for the purposes of this section by an Order made by the Governor, being a function] which in the opinion of the Governor relates to companies or financial services;

"Governor" means the Governor in Council;

"regulatory functions" means functions of a competent authority under any Ordinance or any functions corresponding to such functions, and any other functions relating to companies or financial services, not being the functions of assessing, imposing or collecting taxes.

3. (1) Subject to subsection (2), the powers conferred by section 4 are exercisable by the [Director] for the purpose of assisting a foreign regulatory authority which has requested assistance in connection with inquiries being carried out by it or on its behalf.

(2) The [Director] shall not exercise the powers conferred by section 4 unless he is satisfied that the assistance requested by the foreign regulatory authority is for the purposes of its regulatory functions.

[(2A) The [Director] may decline to exercise the powers conferred by section 4 unless he is satisfied that information furnished pursuant to the exercise of those powers will not be used in any criminal proceedings against the person furnishing it (other than proceedings for an offence under section 7 or for an offence of perjury, or for any like offence).]

(3) In deciding whether to exercise those powers, the [Director] may take into account, in particular:

(a) whether corresponding assistance would be given in the relevant country or territory to an authority exercising regulatory functions in [the Caribbean Overseas Territory];

(b) whether the inquiries relate to the possible breach of a law, or other requirement, which has no close parallel in [the Caribbean Overseas Territory] or involves the assertion of a jurisdiction not recognised by the [the Caribbean Overseas Territory];

(c) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in [the Caribbean Overseas Territory] and whether the assistance could be obtained by other means;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

[(4) For the purposes of subsection (3)(a), the [Director] may require the foreign regulatory authority requesting assistance to give a written undertaking, in such form as the [Director] may determine, to provide corresponding assistance to an authority exercising regulatory functions in [the Caribbean Overseas Territory].

(5) Where a foreign regulatory authority fails to comply with a requirement made under subsection (4), the [Director] may refuse to provide the assistance sought.]

(6) The [Director] may decline to exercise the powers conferred by section 4 unless the foreign regulatory authority undertakes to make such contributions towards the costs of their exercise as the [Director] considers appropriate.

(7) In subsection (3)(a), "relevant country or territory" means the country or territory from which the request for assistance is made.

4. (1) Where in accordance with section 3 the [Director] is satisfied that assistance should be provided pursuant to a request by a foreign regulatory authority, he may in writing direct any person -

(a) to furnish him with information with respect to any matter relevant to the inquiries to which the request relates;

(b) to produce any documents relevant to those inquiries; or

(c) to give him such assistance in connection with those inquiries as the [Director] may specify.

[(3) The [Director] may examine a person on oath and may administer an oath accordingly.]

[(3A) Where a person fails to comply with a direction given under subsection (1) within three days from the date of the direction or such longer period as the [Director] may permit, the [Director] may apply to [a Magistrate] [the court] for an order requiring the person to comply with the direction.

(3B) Where pursuant to a direction given under subsection (1) the [Director] considers it necessary to examine a person on oath, [the Director] may apply to [a Magistrate] [the court] to have that person examined by [the Magistrate] [the court] and the results thereof transmitted to the [Director].

(3C) [A Magistrate] [the court] shall process an application under subsection (3A) or (3B) within seven days and, in the case of subsection (3B), [he] [it] shall transmit the results of the examination to the [Director] within a reasonable period not exceeding fourteen days.]

(4) Where documents are produced pursuant to this section the [Director] may take copies or extracts from them.

(5) A person shall not under this section be required to disclose information or produce a document which he would be entitled to refuse to disclose or produce on grounds of legal professional privilege in proceedings, except that a [lawyer] [barrister or solicitor] may be required to furnish the name and address of his client.

(6) Where a person claims a lien on a document, its production under this section is without prejudice to his lien.

(7) In this section "documents" includes information recorded in any form; and, in relation to information recorded otherwise than in legible form, the power to require its production includes power to require the production of a copy of it in legible form.

5. (1) The [Director] may:

(a) [seek the assistance of the Commissioner of Police in the exercise of his powers under this Ordinance; or]

(b) authorise an officer of his or any other competent person to exercise any of those powers.

(2) No such assistance shall be sought or authority granted except for the purpose of investigating -

(a) the affairs, or any aspect of the affairs, of a person specified by the [Director]; or,

(b) a subject matter specified by the [Director];

being a person who, or a subject matter which, is the subject of the inquiries being carried out by or on behalf of the foreign regulatory authority.

(3) No person shall be bound to comply with a requirement imposed by a person exercising powers by virtue of an authority granted under this section unless he has, if required, produced evidence of his authority.

(4) Where the [Director] seeks assistance or grants an authority under subsection (1), the assistance or authority shall be provided or executed in such manner as the Director may determine; and where the Director grants such an authority to a person other than one of his officers, that person shall make a report to the [Director] in such manner as he may require on the exercise of that authority and the results of exercising it.

6. (1) No information which

(a) is supplied by a foreign regulatory authority in connection with a request for assistance, or

(b) is obtained by virtue of the exercise of powers under this Ordinance, shall, except as permitted by subsection (2), be disclosed for any purpose by the primary recipient, or by any person obtaining the information directly or indirectly from him, without the consent of the person from whom the primary recipient obtained the information and, if different, the person to whom it relates.

(2) Information to which subsection (1) applies may be disclosed:

(a) to any person with a view to the institution of, or otherwise for the purpose of:

(i) criminal proceedings;

(ii) disciplinary proceedings relating to the exercise by a barrister, solicitor, auditor, accountant, valuer or actuary of his professional duties;

(iii) disciplinary proceedings relating to the discharge by a public [servant] [officer] of his duties;

(b) for the purpose of carrying out any duty imposed under any law in force in [the Caribbean Overseas Territory] or by any international agreement to which [the Caribbean Overseas Territory] is a party;

[(c) on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings;]

(d) for the purpose of enabling or assisting a competent authority to discharge any of its functions under any Ordinance;

(e) to the [Governor/Attorney General/public officer approved by the Director] [in the public interest];

(f) if the information is or has been made available to the public from other sources;

(g) in the form of a summary or collection of information framed in such a way as not to enable the identity of any person to whom the information relates to be ascertained;

(h) to a foreign regulatory authority for the purpose of its regulatory functions.

(3) In subsection (1) "the primary recipient" means, as the case may be -

(a) the [Director];

(b) any person authorised under section 5; or

[(c) the Commissioner of Police or any of his officers.]

7. (1) A person who

(a) without reasonable excuse, refuses or fails to comply with any [direction given by the [Director]] [order of [a Magistrate] [the court]] under section 3;

(b) intentionally furnishes false information in purported compliance with any such [direction] [order];

(c) with intent to avoid the provision of this Ordinance, destroys, mutilates, defaces, secretes or removes any document;

(d) otherwise wilfully obstructs any inquiry to which a request from a foreign regulatory authority relates; or

(e) contravenes section 6;

commits an offence.

(2) A person who commits an offence under this section is liable .....

8. No suit shall lie against the [Director] or any person acting under his authority for anything done by him, in good faith, in the exercise of any power or the performance of any function under this Ordinance.

9. This Ordinance shall come into [force] [operation] on such date as the Governor may by proclamation appoint.

MONEY LAUNDERING

INTRODUCTION

1. Money laundering is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises. It is, in effect, the interface between the illegal business sector and the financial sector. Estimates of the size of the phenomenon are hard to come by, but it is generally agreed that it could be in the region of 5% of GDP of the average country.

2. The activity is one of considerable concern for many reasons. If the proceeds of crime are allowed to be lodged unhindered in financial institutions, criminals can gain influence over the institutions and, perhaps eventually control them. Where criminal proceeds are used to buy legitimate businesses, competitors find themselves unable to compete and are driven out of business. Unchecked, money laundering can destabilise financial institutions, sectors and, in certain cases, entire economies. Economic crime can damage financial markets and, thus, the reputation and health of a nation as a whole. It is the concern generated by these implications that have galvanised the international community into making concerted efforts to tackle money laundering.

3. These efforts are highlighted by the following initiatives:

* the 1988 UN Drugs Convention requires parties to criminalise drug money laundering;

* the Financial Action Task Force (FATF) set up in July 1989 by the G7 specifically to develop and promote policies to combat money laundering.

* the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime November 1990;

* the EC Money Laundering Directive of June 1991 requires Member States to prevent the use of their financial systems for money laundering;

* the Caribbean Financial Action Task Force (CFATF) the first regional body to follow the FATF.

4. The White Paper on Britain and the Overseas Territories (Partnership for Progress and Prosperity) noted that the Caribbean Overseas Territories are, in particular, a potential target for money launderers. The OTs should, therefore, have in place comprehensive measures to combat money laundering.

5. The White Paper checklist acknowledged, however, that this is an area in which the OTs have already made good progress. Most have now introduced "allcrimes money laundering legislation". This legislation must, however, be enforced and reviewed regularly. To their credit, all of the OTs are members of the Caribbean Financial Action Task Force and either have, or will shortly undergo, mutual evaluations.

6. The following guidance explains what HMG means by "comprehensive measures to combat money laundering".

INTERNATIONAL STANDARDS

The FATF 40 Recommendations:

7. The 40 Recommendations set the basic framework for anti-money laundering efforts and are designed to have universal application. The principles cover the criminal justice system, law enforcement, the financial system and its regulation and international co-operation. The essential components of the 40 Recommendations are as follows:

* Each country should implement a general framework which ratifies the Vienna Convention, and increases multilateral co-operation on money laundering cases.

* Each country should criminalise money laundering in relation to serious offences, not merely drug money laundering.

* Countries should also put in place measures to enable the tracing, freezing and seizing of criminal assets and the ultimate confiscation thereof.

* The following should be required of all financial institutions, whether they be bank or non-bank institutions:

customer identification "know your customer"

record keeping 5 years

special attention to complex/unusual/large transactions

immunity from prosecution if report suspicion in good faith

internal systems including training and designation of compliance officer

application of these requirements to foreign branches

* Each country should improve spontaneous or "upon request" international information exchange relating to suspicious transactions. This requirement is subject to strict safeguards necessary to ensure consistency with national and international provisions on privacy and data protection.

* Different definitions and standards between jurisdictions should not affect the ability or willingness of countries to provide each other with mutual legal assistance.

* There should be procedures regarding the use of compulsory measures including the production of records by financial institutions.

OTHER RELEVANT STANDARDS

CFATF additional 19 Recommendations:

8. In June 1990 representatives of Caribbean and Latin American States formulated a further 19 Recommendations specifically tailored to regional laws and circumstances. These acknowledged the need to devote adequate resources to this area, the need for competent authorities to specialise in it and that improvements would be ' required to legal systems to enhance the regulation and the role of the financial sector and to improve international co-operation. In particular the CFATF Recommendations urged members to:

* consider the practical evidentiary complications of limiting money laundering to only certain predicate crimes.

* criminalise conspiracy and/or aiding or abetting drug trafficking and money laundering offences.

* to consider making money laundering an offence both where the offender knew or ought to have known the origin of the funds.

* to make money laundering an offence no matter where the predicate offence took place.

* to acknowledge that the fact that a financial adviser is an attorney is insufficient reason to invoke attorneyclient privilege.

EU Money Laundering Directive:

9. Although this has no direct impact on the OTs, it is relevant in so far as it informs the UK law. The EU Money Laundering Directive of 10 June 1991 (91/308/EEC) requires Member States to prevent the use of their financial systems for money laundering. The EU suggests three main steps to combat money laundering: criminalise it; take measures to identify laundered proceeds with a view to confiscation; pass laws and establish systems to prevent the proceeds of crime being laundered in the first place.

10. The Directive also sets out requirements to be placed on the credit and financial institutions (as defined) of the Member States' jurisdictions. This includes customer identification and retention of records, relating to identification and transactions, for a period of five years. The Directive goes on to require Member States to place a requirement on such institutions to inform the authorities about suspected money laundering activity.

The UK law and practice:

11. The UK implemented the EU Directive by means of the Criminal Justice Act 1993, the Money Laundering Regulations 1993 and earlier legislation. The principal money laundering offences are set out in the Prevention of Terrorism (Temporary Provisions) Act 1989 and the Drug Trafficking Act 1994. The Criminal Justice Act 1988, as amended, contains the money laundering offences relating to the proceeds of crimes other than drug trafficking and terrorism. These are defined as all indictable offences, other than those covered by the 1989 and 1994 Acts, plus the summary offences set out in Schedule 4 to the 1988 Act. The latter include certain lucrative offences relating to sex establishments and the supply of unclassified videos.

12. The principal money laundering offences have a dual purpose. Firstly, to criminalise and so suppress money laundering activity. Secondly, to encourage the reporting of suspicious transactions to the authorities. In this second respect, the offences help to protect the integrity of financial institutions by deterring criminals from lodging proceeds in them, and also help to provide the police with new investigative leads.

Criminal Justice Act 1988, as amended by the Criminal Justice Act 1993:

13. The money laundering offences created by this legislation are as follows:

Assisting another to retain the proceeds of crime: to commit this offence, one must know or suspect that the person in question is or has been engaged in crime, or has benefited from it.

Acquiring, Possessing or using another's proceeds of crime: the offence only applies where the launderer acquires, possesses or uses the property for inadequate "consideration,' (payment). Thus, if one pays full value for the property one does not commit the offence. The provision of goods or services which are of assistance in criminal conduct is not regarded as "consideration".

Concealing another person's proceeds of crime: This includes concealing or disguising property; or converting or transferring property or removing it from the jurisdiction. Carrying out these activities must be for the purpose of assisting somebody to avoid prosecution for a relevant offence or the making of a confiscation order against him/her. Unlike the above offences, all that is required here is "reasonable grounds for suspicion". Thus the prosecution need only prove that the person laundering the proceeds **should have suspected.**

Laundering one's own proceeds: This includes the same activities as concealing another person's proceeds and one must conceal, disguise, convert, transfer or remove property from the jurisdiction for the purpose of avoiding one's own prosecution for a relevant offence or the making of a confiscation order against oneself.

14. The penalties for all of the above offences are fourteen years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction (currently £5,000).

15. The legislation also includes the following offences:

Tippingoff offences: These apply when a money laundering investigation is being, or is about to be, conducted, and where a suspicious transaction report has been made, or a suspicion of money laundering has been disclosed to the authorities. The offence can be committed where one knows or suspects that an investigation is being conducted, or is about to be, or a disclosure has been made.

16. The penalties for tippingoff are five years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction.

The Money Laundering Regulations 1993:

17. Another essential part of the UK's antimoney laundering defences are the Money Laundering Regulations. They require financial institutions to put in place systems to deter money laundering and to assist the authorities to detect money laundering activities. The Regulations apply to:

* all banks, building societies and other credit institutions,

* all individuals and firms authorised to conduct investment business under the Financial Services Act 1986,

* all insurance companies covered by the EC Life Directives, including the life business of Lloyds of London,

* all other undertakings carrying out any of the range of financial activities listed in the annex to the Second Banking Directive (89/646/EEC, SI 1992,3218). This includes bureaux de change and money transmission services.

18. The Regulations establish criminal offences for those who fail to ensure adequate systems are in place and maintained. Thus, the Regulations require:

* procedures to ensure identification of customers, maintenance of records relating to identification and transactions, or such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering;

* appropriate measures to be taken from time to time to make employees who handle relevant financial business aware of the procedures and the money laundering statutes;

* provision of training for those employees from time to time in the recognition and handling of transactions which may be money laundering.

19. Where an offence is committed by a body corporate, partnership or unincorporated association, the directors and managers and certain other people may be guilty of the offence as well. Penalties for contravention of the Regulations are two years imprisonment and an unlimited fine on indictment and a fine not exceeding the statutory maximum on summary conviction.

Money Laundering Guidance Notes:

20. In addition to the above, the British Bankers Association have produced guidance notes for the industry in association with the Building Societies Association and the law enforcement authorities. Similar guidance notes have also been produced for the insurance and investment business sectors.

COMPLIANCE WITH THESE STANDARDS

21. With regard to the OTs, we have encouraged the OTs to put in place measures equivalent to those in the UK. Most have now implemented the primary legislation. However, work on the essential supporting measures still needs to be completed.

Regulations:

22. Many OTs have opted to implement voluntary codes of practice rather than an equivalent to the UK Money Laundering Regulations 1993 (the Regulations). **To be effective these need to be placed on a statutory footing** providing for criminal offences in the event that monitoring and reporting systems are not created and maintained.

23. Effective operation of the antimoney laundering legislation relies on the vigilance of financial institutions and the reporting of suspicious transactions. While the requirement to put in place monitoring and reporting systems is voluntary, the risk of commercial interest frustrating the intent is concrete. Placing these requirements on a mandatory footing would enable the OTs to ensure that the supporting mechanisms for their money laundering defences could be enforced. It would also send a clear signal to the financial sector that "all money is not simply money", and that certain types of financial activity were unacceptable.

Resources and enforcement:

24. It is clear from the above that the creation of anti-money laundering defences requires considerable input of resources on the part of the financial institutions. This, however, is only one part of the equation. There is little point in requiring the financial sector to report suspicious transactions if there is an inadequate ability on the part of law enforcement to respond.

This means that OT Governments must devote considerable resources to ensuring that the law enforcement capacity for analysing suspicious transaction reports and, where appropriate, acting on them is sufficient. This will apply not only to reports submitted by institutions operating within the jurisdiction, but also to requests for assistance on money laundering investigations from foreign jurisdictions. It is, therefore, essential that the Financial Investigation and Intelligence Units in the OTs are adequately staffed with trained personnel capable of conducting financial investigations and analysis.

25. In addition, it will also be necessary to ensure that the Attorney Generals' Chambers and the judiciary in each OT are appropriately resourced and trained to handle the types of cases which may result from enforcement of the money laundering laws. Again, this relates not merely to prosecutions of offences within the OTs, but also to provision of assistance to foreign jurisdictions in pursuance of the antimoney laundering legislation. Where appropriate, HMG is willing to provide assistance on a short term basis. However, it will be for the OTs to ensure that they budget appropriately for these responsibilities in the future.

International co-operation and confiscation:

26. It goes without saying that a great deal of money laundering involves transactions spanning a number of jurisdictions. The more complex the transactions and the more jurisdictions involved, the harder it is for law enforcement to follow the money trail. The abolition of exchange controls in the late seventies and early eighties, and the rapid improvement in technology means that it is possible instantly to transfer money of any amount or denomination virtually anywhere in the world. Much criminal law is territorially based, and differs from jurisdiction to jurisdiction, so the investigation and prosecution of financial crime and money laundering are very dependent upon mutual legal assistance between states.

27. The confiscation and money laundering legislation which the OTs have been enacting enables many of them to co-operate in international asset tracing investigations, and in the restraint and confiscation of the proceeds of drug trafficking and other crime. Given the percentage of financial business in the OTs which has its origins in other jurisdictions, it is vital that these provisions for international cooperation are fully implemented and, when implemented, operate effectively. At a time when much attention is being focused internationally on offshore centres, it is in the OTs interests to ensure their reputation for being willing and able to assist in tracing, freezing and confiscating criminal proceeds is second to none.

28. HMG is mindful of OT concerns that they may invest considerable resources in providing investigative assistance in proceeds of crime cases, only for the assets to be confiscated elsewhere and retained by the confiscating jurisdiction. In our view, international asset sharing from which some OTs have benefited considerably in recent years provides the best way to ensure that the costs of international casework is shared equitably among cooperating jurisdictions. we strongly support the sharing of confiscated assets relating to all crimes, including drug trafficking, and are working internationally to promote progress in this area. We are happy to discuss continuing concerns about costs with the OTs, and have asked them whether they would be interested in having the Council of Europe Convention extended to their jurisdictions.

Fiscal offences:

29. International standards indicate that money laundering should be criminalised in relation to all serious crime, not merely drug trafficking. The principles leave the definition of serious crime to the individual jurisdictions. At the same time, however, **they also make it clear that such individual definitions should not affect the ability "or willingness" of countries to provide mutual legal assistance.**

30. In the UK we treat tax evasion as a serious crime so it is caught by our confiscation and money laundering legislation. We are aware that different jurisdictions treat specific tax offences in different ways. Experience suggests that this can create problems where money laundering investigations relate in some way to tax offences.

31. The "tax issue" can arise in two ways. First, the predicate offence to which the money laundering offence relates is a tax offence. Assume the predicate offence takes place in jurisdiction A and the money laundering offence takes place in jurisdiction B. A problem is created where the latter does not recognise the tax offence in question as a predicate offence to which its money laundering legislation applies. As a result it will not provide co-operation to jurisdiction A in its investigations. Second, the predicate offence may be another serious crime, such as drug trafficking. It is, however, disguised as a tax related problem to ease the process of laundering. Nonrecognition of tax offences, or non-cooperation on money laundering cases involving such offences can frustrate all sorts of criminal investigations. In either of these scenarios, the inability to cooperate where tax is, or appears to be, involved creates a loophole in the anti-money laundering defences which criminals will utilise.

32. Failure to provide adequate coverage for this issue in the antimoney laundering defences has two serious drawbacks. it makes it easier for criminals to get away with tax evasion, which we regard as a serious crime, and it undermines efforts to

combat other forms of offending.

33. There is some concern that the inclusion of tax offences as predicate offences, for the purposes of the money laundering legislation, will place a requirement on financial institutions to know and understand the fiscal regimes in other jurisdictions. This is quite wrong. Under the money laundering offences one is only required to consider whether one has a suspicion of something which would be a crime in one's own jurisdiction. it is also argued that it is difficult or impossible to determine whether a transaction is indeed linked to drug trafficking, tax or any other specific crime. However, the financial institutions and their employees are not expected to investigate suspicions, but to disclose them. As noted above, in the case of the UK, this includes disclosing suspicions of tax evasion. It is worth noting, however, that cooperation on money laundering investigations involving tax offences does not necessarily require such offences to be made predicate. There may be other related offences which fall within the ambit of a jurisdiction's money laundering legislation.

34. There is also an argument that "there is no such thing as the laundering of money from tax fraud', on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime.

35. The UK's confiscation, money laundering and judicial co-operation legislation enables us to trace, freeze and confiscate the proceeds of tax evasion, or any other crime, on behalf of other jurisdictions. Where restraint and confiscation are concerned, the conduct overseas must correspond to an applicable offence in the UK. **However, much investigative assistance can be provided without any dual criminality requirement.** We can, and do, assist in foreign tax evasion cases, including cases where the conduct is not necessarily an offence in the UK.

36. As part of the efforts to combat money laundering, the UK is encouraging others to close loopholes. We would, therefore, encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able.

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3 (Copies of Guidance Notes to be provided to Consultants.) Back

4 Clive Briault: *The Rationale for a Single National Financial Services Regulator* - May 1999 Back

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We welcome your comments on this site.

Prepared 27 October 2000

Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda — Cayman Islands

1 Executive summary

1.1 Introduction

This is one of six reports we have issued covering the review of financial regulation in the Caribbean Overseas Territories and Bermuda. This report deals with the Cayman Islands.

The Cayman Islands is a British Overseas Territory situated 268 km north-west of Jamaica in the Caribbean Sea and have an area of about 260 square km. The Cayman Islands have a large measure of self-government. The Governor retains responsibility for the civil service, defence, external affairs and security but not financial services. The Constitution, which came into effect in 1972, provides for a system of government headed by a Governor, an Executive Council and Legislative Assembly. The estimated population of the Cayman Islands in 1997 was 36,600. Its GDP per capita (estimated) in 1998 was US$30,120 with an estimated growth rate of 5.5%. Offshore finance and tourism are the two main pillars of the economy.

1.2 Financial services activity in the Cayman Islands

The Cayman Islands is one of the world's largest banking centres. At present the banking sector in the Cayman Islands comprises over 450 banks from sixty-five countries that hold assets of US$671 billion. 43 of the world's top 50 banks have a branch or locally incorporated subsidiary in the Cayman Islands. There are 430 Category B banks of which 51 have established physical presence in the jurisdiction.

The Cayman Islands have also grown as a centre for insurance and are now the second largest captive insurance centre in the world with 502 captive insurance companies, largely from the US market.

The Cayman Islands is also a significantly large centre for the establishment and administration of mutual funds. There were 2,298 regulated mutual funds as at 7 March 2000, being 603 administered, 1,654 registered and 41 licensed schemes.

As at 31 December 1999, the Cayman Islands had 3,614 resident companies, 11,342 non- resident companies and 34,500 exempt companies.

The Cayman Islands also have significant numbers of trusts and limited partnerships.

In general, the Cayman Islands is one of the more mature of the jurisdictions we have reviewed in terms of regulatory structure and culture.

1.3 Financial services regulation

There are two bodies responsible for financial service regulation in the Cayman Islands. These are the Cayman Islands Monetary Authority ("CIMA") and the Stock Exchange Authority (the "Authority").

CIMA is responsible for the day-to-day supervision of banks, trust companies, mutual funds, mutual fund administrators, insurance and company managers. It is also responsible for the management of the Cayman Islands currency.

The Authority is responsible for the regulation of the Cayman Islands Stock Exchange ("CSX"). The Authority has no full-time staff and its supervisory activities are limited to monthly reports provided by the CSX and review of the CSX annual report before it is tabled in the Legislative Assembly. The Authority also has to review and approve any rules that CSX wishes to introduce.

Since the date of our on-site review, the Cayman Islands Legislative Assembly has passed on 14 July 2000 the following legislation, designed to improve regulatory access to information and international regulatory co-operation and to bring the anti-money laundering legislation into compliance with the 25 criteria introduced by the FATF in February 2000.

- The Monetary Authority (Amendment) (International Co-operations) Law, 2000 ("MAICL");
- The Banks and Trust Companies (Amendment) (Access to Information) Law, 2000 ("BTCAIL");

- The Companies Management (Amendment) (Access to Information) Law, 2000 ("CMAIL");
- The Proceeds of Criminal Conduct (Amendment) Money Laundering Regulations Law, 2000.

The Money Laundering Regulations under the latter legislation were gazetted on 7 August 2000.

1.4 Summary of principal findings

1.4.1 Regulatory authority

By the creation of CIMA in 1996, the Cayman Islands commenced a positive process of developing a structured and resourced regulatory function, and a visible commitment to achieving international standards and good practice. We consider that CIMA, staffed as it is with a number of experienced and skilled regulators, some with international regulatory experience, provides a firm foundation for the attainment of those international standards with which it does not already comply.

Furthermore, the Cayman Islands, with the recent passage of legislation relating to international co-operation and anti-money laundering, have made significant improvements in the area of access by CIMA to information for regulatory purposes and international regulatory co-operation. There are a number of issues where attention needs to be focused The most important of these relate to the current lack of full operational independence for CIMA and the need for significant extra staffing to fulfil all the necessary activities that must be undertaken to fully comply with international standards. We note that the operational independence of CIMA, is being addressed by the Cayman Islands Government but has not yet been resolved.

In respect of the Stock Exchange Authority, although activity to date at the CSX has not resulted in any regulatory problems, we do not consider that a regulator without its own dedicated resource can meet international standards. We believe that action is necessary to provide adequate supervision of the CSX, and have recommended appropriate improvements.

1.4.2 Banking

The Cayman Islands have demonstrated a proactive approach to bank supervision, both generally and particularly in the area of Category "A" (domestic) Banks, and over recent years have significantly increased the quality of banking supervision. This progress is particularly welcome given the importance of the Cayman Islands as a banking centre.

However, CIMA are aware that there are a number of areas of banking supervision, particularly in respect of category B banks, where additional action is needed in order to fully meet the requirements of international good practice as laid down by the Basel Committee. In particular there is a significant need to increase the number of on-site visits, in addition to operational independence and resourcing.

1.4.3 Insurance

Whilst there is a need to expand the enforcement powers available to CIMA in respect of insurance licence holders, we consider that the regulation of insurance is generally in line with international standards.

1.4.4 Securities/investments

The Cayman Islands recognise that they are currently failing to meet international standards as laid down by IOSCO due to the lack of current legislation covering the regulation of securities/investment business beyond that relating to members of the CSX and mutual fund administrators.

This is a weakness which the Cayman Islands is currently seeking to address through new legislation due to be introduced in April 2001.

It should however be noted that, unlike a number of other jurisdictions, the Cayman Islands treats fund administration as a regulated activity. We consider this approach to represent good practice.

We consider that the high priority that Cayman Islands is currently giving to this legislation is appropriate and to be welcomed.

1.4.5 Mutual funds

The existence of a regulatory and supervisory structure for mutual funds in the Cayman Islands is a positive feature of the jurisdiction's regulatory environment. A number of features of the legislation, including the wide ranging enforcement

powers, meet IOSCO standards.

Nevertheless, given the size of the mutual fund industry in the Cayman Islands, it is vital that the regulatory and supervisory regime is robust. We consider that a number of matters need to be addressed in order to ensure compliance with international standards.

The principal of these are the lack of regulations relating to the operation of public funds, including the segregation of client monies, together with the lack of a current on-site inspection programme and the limited nature of the off-site review must be seen as priorities for action.

1.4.6 **Stock exchange**

Whilst the CSX has a trading platform, to date it has provided a listing function only. This acts as a mechanism to provide marketability to mutual funds, derivative warrants and specialist debt. We consider that, given its current functions, membership and listing regulation meet international standards.

1.4.7 **Companies**

We have not undertaken a detailed review of company law as this is beyond our terms of reference for this review. Therefore our specific comments and recommendations should not be taken as being the only amendments which may be required. We have, however, reviewed those aspects of the legislation which bear directly on our TOR and taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

Based on our overview, while provisions exist at common law, we consider that the Companies Law lacks many of the features found in a modern piece of companies' legislation and is in need of review. We recommend that the review should include insolvency provisions, control over the issue of prospectuses, the protection of the interests of minority shareholders, enforcement powers, the disqualification of directors and auditing of public companies.

The issue of bearer shares is particularly important. We note that the Cayman Islands intends to introduce legislation in 2001 to immobilise bearer shares.

1.4.8 **Company service providers**

The Cayman Islands has a reasonable regulatory structure in place for the supervision of company management and administration. We consider this to be a positive feature of the regulatory structure and one that exists only in a limited number of other jurisdictions.

However, the legislation is effectively limited in scope to those company service providers who provide fiduciary services. Some (the proportionate amount is not discernible) traditional company management business, including the formation of companies and the provision of registered office services, is outside the scope of the legislation and of the regulatory net, as it is in a number of major centres. We do not consider that this meets the international and good practice standards set out in the Guidance Notes.

Furthermore, the current supervisory process is in need of development. In particular, the limited supervisory resources and the lack of on-site supervision is of concern.

1.4.9 **Partnerships**

We are of the view that the legislation and systems in place in the Cayman Islands concerning limited partnerships meet a number of good practice requirements but do not meet all of them.

Our principal recommendations to overcome the existing weaknesses are:

- that the forming of limited partnerships and the provision of registered offices for partnerships should become a regulated activity;
- that where the accounting records of a limited partnership are not kept at its registered office, the registered office should maintain a written record of where they are kept; and
- that the Registrar of Companies (who is also responsible for the registration of limited partnerships) should have enforcement powers to:

(1) apply to the courts for the dissolution of a partnership on public interest grounds or on grounds of fraud or insolvency; and

(2) apply to the courts for the appointment of an inspector to investigate the activities of a limited partnership.

1.4.10 **Trusts**

Trust legislation in the Cayman Islands is similar to the trust legislation in a number of other jurisdictions, including England. In general, we do not consider that there are any particular features of the Trusts Law that are likely to lead to trust structures in the Cayman Islands being any more or less attractive to criminals or money launderers than trusts in other jurisdictions.

We consider that the Special Trust Alternative Regime ("STAR") Law provides protection in respect of non-charitable trusts and exceeds good practice standards. In respect of asset or creditor protection trusts and purpose trusts, we consider that the Cayman Islands legislation is conservative and meets good practice standards.

1.4.11 **Trust service providers**

Unlike a number of jurisdictions, both onshore and offshore, the Cayman Islands regulate the provision of trust services and therefore are already addressing many areas of good practice.

Nevertheless, the current regulatory supervisory regime does need enhancement to fully meet the good practice requirements. The principal areas for improvement are:

- the current exclusion from regulation of those who undertake trust service provision as an individual or partnership should be ended;
- the on-site and off-site inspection process should be improved;
- there should be an enforceable supervisory code of practice for licence holders; and
- there should be an enhancement of CIMA's enforcement powers.

1.4.12 **International co-operation**

The Cayman Islands now has strong international co-operation arrangements and the recent changes to the Monetary Authority Law in particular demonstrate its commitment to developing its level of international co-operation. There remains a need for further improvement in some areas in order to demonstrate full compliance with international standards and good practice and these are detailed in Section 14 Given the extent of the recent legislative developments, the implementation of these changes, as a matter of prudent management, need to be monitored by Cayman to confirm that they provide the desired capability to co-operate in practice.

1.4.13 **Anti-money laundering**

The Cayman Islands has introduced a number of significant legislative and regulatory provisions designed to bring it into compliance with international standards, including modern "all crimes" money laundering legislation. The legislation taken as a whole is extensive and contains much of the material and covers most of the issues that we would expect in a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of the Cayman Islands' commitment to prevent money laundering.

Some enhancements are required to the Misuse of Drugs Law ("MODL"). In addition, the Code of Practice now needs to be reviewed to ensure that it takes account of the Money Laundering Regulations 2000.

1.5 **Conclusions**

The creation of CIMA has made a significant contribution to the improvement of the regulatory regime in the Cayman Islands and demonstrates their seriousness in developing compliance with international standards. Furthermore, the proposal for CIMA to become operationally independent is to be welcomed.

The Cayman Islands have also enhanced markedly their ability to co-operate with regulators and law enforcement bodies in other jurisdictions.

We welcome the recent introduction of legislation to improve assistance to foreign regulators in obtaining relevant information from the Cayman Islands for supervisory purposes and for civil and administrative proceedings as well as to permit regulatory access to specific client files for regulatory supervision purposes. This capability, which was introduced during the course of our review and meets a number of recommendations made in earlier drafts of our report, should, as a matter of prudent management be monitored by Cayman to ensure that it is effective in practice.

The size of the financial sector in the Cayman Islands, in comparison with the current resources of CIMA, means that we consider that CIMA is under resourced and is unable to fully meet the appropriate international standards without additional staff. Such staff will enable CIMA to undertake the necessary additional regulatory activities, including a significantly increased number of on-site visits. We therefore support CIMA's decision to undertake a formal analysis of staffing needs.

We welcome your comments on this site.

Prepared 27 October 2000

2 Methodology

2.1 Introduction

2.1.1 The UK Government White Paper

The UK Government White Paper "Partnership for Progress and Prosperity: Britain and the Overseas Territories" ("the White Paper")[1] was presented to the UK Parliament in March 1999.

The White Paper recognised that the international financial service industry has grown dramatically in recent decades and that a significant number of the Overseas Territories have developed successful offshore financial sectors and so diversified their economies. The White Paper further commented that it was essential for the future of the financial services sector that the Overseas Territories reputation for honest administration and probity be preserved and enhanced.

The White Paper stated that development of sizeable financial sectors brings risk of abuse and that as markets develop and techniques for laundering money, fraud, tax evasion and regulatory abuse evolve so financial regulatory systems must improve, be updated and be responsive to ever tighter international standards.

The White Paper further stated that the Caribbean Overseas Territories in particular are a potential target for money launderers because of their offshore financial business, their proximity to major drug producing and consuming countries and, in some cases, their inadequate standard of regulation and strict confidentiality rules. The White Paper also stated that the Territories are also at risk from attempted fraud and that failure to tighten regulation could affect the stability of and confidence in financial markets. The White Paper emphasised the importance of the Overseas Territories meeting accepted international standards. To assess progress made in this area, it required an in-depth independent review to be undertaken by regulatory experts. This review was also to make recommendations as to how to deal with any issues outstanding.

2.1.2 Development of the review process

Following the publication of the White Paper, a Steering Committee was formed. This Committee comprised representatives of the Foreign and Commonwealth Office ("FCO"), the Treasury, the Financial Services Authority and the Governments of the Overseas Territories.

The Steering Committee approved the Terms of Reference ("TOR") for this review, together with Guidance Notes on international standards and good practice relating to the areas under review. We understand that the guidance on accepted international standards in financial regulation ("the Guidance Notes") contained within the TOR was arrived at following a process of detailed consultation and discussion between representatives of the Overseas Territories, the FCO, HM Treasury and the UK Financial Services Authority. These are attached in Appendix 1.

The Guidance Notes represent good practice. The Overseas Territories have therefore chosen to be assessed against standards which, in a number of areas (such as company and trust service provision), are not applied in a number of major centres. This approach demonstrates the commitment of the Overseas Territories in seeking to ensure that financial regulation in these jurisdictions will eventually meet high standards. As such they are providing a powerful role model to other offshore centres.

The Guidance Notes do not prescribe how particular standards should be achieved; rather, the Overseas Territories are left to decide for themselves how best to achieve the standards laid down in them.

On 20 December 1999 we were appointed by the FCO, acting on behalf of the Steering Committee, to undertake the review of financial regulation referred to above.

The review covers Anguilla, Bermuda, the British Virgin Islands ("BVI"), the Cayman Islands, Montserrat and the Turks & Caicos Islands ("TCI") (referred to collectively as the Overseas Territories). The White Paper covers a wider number of locations (such as Gibraltar) but this review is restricted to these six Overseas Territories.

The purpose of the review has been to assess the Overseas Territories' performance against international standards and good practice, and to make recommendations for improvement where any territory falls below those standards.

2.2 **Scope of the review**

The scope of the review was as follows:

In relation to the regulation of financial services activity

- List separately the type and composition of offshore financial services business in each Overseas Territory.
- Ascertain what legislation, regulations, rules, guidance, systems and procedures (statutory or otherwise) govern the regulation and supervision of the:

  - Banking sector

  - Insurance sector

  - Securities sector (including mutual funds and stock exchanges).

- Assess the monitoring, supervision and regulation of activity as well as the enforcement of rules, regulations and laws.
- Evaluate to what extent arrangements in the Overseas Territories meet the standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).
- Consider the adequacy of the system of supervision relative to the objectives of Overseas Territories' financial services regulation.
- Comment on the existence and adequacy of depositor and investor protection schemes.
- Determine whether further action is required by any territory in order to meet the standards set out in the Guidance Notes and prioritise recommendations.

In relation to the regulation of companies, partnerships and trusts

- Ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts.
- Detail the type of information available on the activities of companies, partnerships and trusts.
- Determine whether the regulatory mechanisms in place are sufficient to meet international standards.
- Consider whether further action is required by any Overseas Territory to meet the standards required and prioritise recommendations.

In respect of independent regulatory authorities

- Evaluate to what extent regulatory authorities comply with accepted international standards advocated principally by Basel, IOSCO, the Offshore Group of Banking Supervisors (OGBS) and IAIS.
- In particular, evaluate whether regulatory authorities are accountable, independent and free from business and political influence and properly staffed and budgeted for with an independent source of income.
- Determine whether the relevant authority is detached from the marketing of financial services and, where this is not so, assess any impact this may have on the ability of the regulatory authority to regulate the sector objectively.
- Assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; co-operate with requests for assistance from foreign authorities; enforce rules, regulations and laws by taking enforcement action; and the extent to which they can liaise with law enforcement authorities in the sharing of information.
- Consider which activities fall under the responsibility of the regulatory authority and whether the regulatory net

covers all financial activities.

- Consider what legal advice is available to the authority and its effectiveness in helping the Overseas Territory's government to regulate the sectors.

In relation to international co-operation

- Evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of the Overseas Territory's law enforcement and regulatory authorities to co-operate with requests for assistance from foreign authorities.
- Ascertain what legal advice is available to regulatory and law enforcement authorities in the Overseas Territory, and determine effectiveness in helping the Overseas Territory's government to co-operate in these areas.
- Determine whether further action is required by any territory in any of these areas, and the relative priority of such action.
- Consider whether there are effective "gateways" provisions in place concerning co-operation between regulatory authorities as well as the Overseas Territory's powers to obtain information, including by compulsion, the ability of foreign authorities to take voluntary testimony from the Overseas Territory's residents and the Overseas Territory's ability to safeguard the confidentiality of information provided by foreign counterparts. In addition, determine whether there are any provisions governing conditions under which information may be passed to overseas jurisdictions and whether effective memoranda of understanding exist (where required to underpin co-operation).
- Assess the extent to which the Overseas Territory's law enforcement authorities can obtain evidence on behalf of their foreign counterparts and exercise other available mutual legal assistance powers, stating the mechanisms and the Overseas Territory's authorities involved.
- Assess the Overseas Territory's ability to assist foreign authorities in tracing, freezing and confiscating proceeds even if the underlying conduct takes place outside the Overseas Territory.
- Assess the effectiveness of mutual legal assistance treaties with the USA where applicable and provide the basic volume of requests for assistance made and received.
- Assess powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted.
- Assess the ability to safeguard the confidentiality of information provided to Overseas Territory's law enforcement authorities.
- Assess whether effective memoranda of understanding exist, where required, to underpin co-operation.
- Evaluate whether there is effective co-operation between law enforcement authorities and financial regulators both domestically and abroad.
- Consider the ability of the Overseas Territories' regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

In relation to measures to combat money laundering

- Establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the Overseas Territories to combat money laundering and types of offences caught by the legislation.
- Determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.
- Evaluate the effectiveness and adequacy of those arrangements in terms of how they meet the applicable international standards.
- Provide specific consideration to the offences considered predicate for the purposes of money laundering legislation.

- Consider whether the Overseas Territories' have regulatory legislation in addition to the principal money laundering offences and, if not, whether guidelines and/or codes of practice exist (statutory or otherwise).
- Consider the Overseas Territories' systems for reporting suspicious transactions and identifying customers, the institutions obliged to report, how reports are dealt with and within what timeframe.
- Consider how this information is disseminated and shared with foreign counterparts.
- Evaluate the ability of financial intelligence units or their equivalent to deal with suspicious transactions.
- Determine to what extent the Attorney-General's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws.

2.3 **Project governance**

2.3.1 **The Steering Committee**

The Steering Committee played a key role in setting the parameters for and guiding the conduct of the review by its involvement in:

- agreeing the TOR and benchmark standards to be applied by the review team prior to its appointment;
- offering guidance over the detailed review process through a series of Steering Committee meetings which took place at key stages in the review process; and
- agreeing the format and reviewing the content of this report and providing comment as appropriate.

The responsibility for the opinions expressed, is however, a matter for KPMG.

2.3.2 **The Strategic Team**

In undertaking the review, KPMG utilised a Strategic Team composed of former senior regulators from a number of different jurisdictions, as well as its own partners and staff. The involvement of these individuals enabled the assessment better to take into account how the standards are implemented in practice on an international basis.

Members of the Strategic Team have had significant involvement in the setting of international standards as well as their implementation. The team included a former Chairman of IOSCO's Technical Committee, the Director of Regulation at Lloyd's of London, a former Deputy Director of the United States Securities and Exchange Commission of International Affairs, a former executive Director of the Hong Kong Securities and Futures Commission and the former Chief Executive of the Isle of Man Financial Supervision Commission.

The external members of the Strategic Team provided advice and guidance to KPMG, particularly during the early stages of the project and through the initial drafting of this report. The role of the external members of the Strategic Team was advisory, however, and the analysis and recommendations in this report are the responsibility of KPMG.

2.3.3 **Responsibility for this report**

This report has been prepared by the UK firm of KPMG. Although we have associated firms in the Overseas Territories, they have not been involved in the preparation of this report, nor should any responsibility for any of the opinions in this report be attributed to them.

2.4 **Approach to the review**

2.4.1 **Structure of the report**

The individual sections of the report are generally divided into a number of parts, as follows:

- an introduction, giving a broad outline of the international standards and/or good practice against which our assessment is made;
- a description of the nature and scale of the activity in the jurisdiction;

- a factual assessment produced in conjunction with the Overseas Territory which has been formally confirmed by them as accurate; and
- a section covering the issues arising from our analysis, together with recommendations we consider appropriate to remedy any deficiencies identified.

2.4.2 **Benchmarks**

In determining the appropriate international standards and good practice we have, as instructed in the TOR, used the Guidance Notes.

In the areas of banking, insurance, securities/investments and stock exchanges there are established international standards by which compliance can be assessed. Similarly, with respect to anti-money laundering measures, the recommendations of the Financial Action Task Force and the Caribbean Financial Action Task Force provide benchmarks.

However, in other areas, such as the provision of company and trust services, there are no internationally accepted standards. The Guidance Notes have instead been based upon what has been agreed as good practice.

In accordance with the TOR we have, in conducting this review, taken due notice of the recommendations made in the recent Home Office report on the Review of Financial Regulations in the Crown Dependencies. It should be noted however, the terms of reference for the two reviews are substantially different in that benchmark standards were not defined in the Home Office review and hence there was no requirement to make an assessment against them.

Accordingly, in framing our recommendations we have assessed compliance with the benchmark standards set out in the TOR.

2.4.3 **Phases of the review**

2.4.3.1 ***Legislative review***

At the outset of the review the Overseas Territories provided us with copies of relevant legislation and regulations.

2.4.3.2 ***Pre-visit questionnaires***

Prior to commencing our on-site reviews, we prepared a pre-visit questionnaire for completion by each of the Overseas Territories. The questionnaire covered the areas required by the TOR. A draft questionnaire was reviewed by the Steering Committee and their comments were incorporated prior to issue. Comments were also invited and received from other parties with experience in relevant areas, for example the FATF in respect of money laundering.

Following this consultation the questionnaire was issued and responses received from the Overseas Territories. These responses were analysed by us prior to the commencement of the on-site review.

2.4.3.3 ***On-site review programme***

The analysis of questionnaire responses was used to prepare a work programme for the on-site review. This mechanism was important in ensuring that the on-site stage of the work was completed to a consistent standard across all the Overseas Territories.

2.4.3.4 ***On-site review***

The on-site review was undertaken in March and April 2000. It comprised in excess of twenty-six man weeks in the Overseas Territories. A total of eight staff, together with two members of the Strategic Team, were deployed across the Overseas Territories. Each consultant was allocated a specific area for review in line with their sector specialism. Work was conducted in line with the on-site review programmes outlined above, adjusted where necessary for issues identified on-site.

2.4.3.5 ***Meetings with third parties***

As part of the review process we had extensive discussions and meetings with third parties (in the UK, the Overseas Territories and elsewhere) who had experience of, or an interest in, the jurisdictions under review. These third party discussions were particularly pertinent in the areas of international co-operation and anti-money laundering measures.

Meetings with the third parties referred to above included:

- The United States Securities and Exchange Commission ("SEC");
- The United States Department of Justice ("DoJ");
- Representatives of the Overseas Territories;
- The United States Federal Reserve;
- The White Collar Criminal Investigation Team ("WCCIT");
- The Overseas Territories Regional Criminal Intelligence System ("OTRCIS");
- The Financial Services Authority ("FSA");
- The National Criminal Intelligence Service ("NCIS"); and
- The Ontario Securities Commission ("OSC").

2.4.3.6 ***Findings from previous reviews***

Our review also considered the results of previous reviews of sectors of the various Overseas Territories. These included:

- the 1992/3 Bank of England "Report on the arrangements for the supervision of offshore banks", covering Anguilla, the BVI, Montserrat and the TCI;
- the CFATF mutual evaluation of Bermuda, the BVI, the Cayman Islands and the TCI; and
- the 1993 Sullivan Reports on the regulation of insurance in Anguilla, the BVI, the Cayman Islands, Montserrat and the TCI.

In addition to the above, we have used other information sources including promotional and advisory material issued by the Overseas Territories and others.

2.4.3.7 ***Reporting***

Whilst we have sought to give due credit for regulatory achievement wherever possible, it should be noted that our reports are phrased on an exceptions basis. We have identified issues and made recommendations in those areas where we consider they are required. The nature of our issues and recommendations tend to reflect the stage of regulatory development reached by the jurisdiction in question.

Those jurisdictions with more mature financial sectors and better developed regulation have tended to generate more detailed recommendations.

In those jurisdictions where we have identified a more significant lack of basic regulatory structures, our recommendations are, necessarily, focused on the major issues to be addressed. There will inevitably be many subsidiary issues which will need to be considered following action on those which are more fundamental. It is impossible to anticipate these until those more significant issues have been addressed.

2.4.3.8 ***Confirmation of factual accuracy and discussion of findings***

Following the on-site reviews, we issued initial draft reports in May 2000. We then visited each of the Overseas Territories over a two-week period at the end of May.

This second visit was designed to give the Overseas Territories the opportunity to comment on findings and confirm the factual accuracy of the initial draft reports. Comments received during the course of this visit were confirmed (where they related to issues of factual accuracy) and considered. Our draft reports were adjusted where the review team considered this to be appropriate.

Following these second on-site visits, further draft reports were prepared. These were issued on 17 July. They were also discussed with the Overseas Territories who (along with the Steering Committee) were again given an opportunity to comment. Written as well as oral comments were received from the Overseas Territories and others; all have been carefully considered.

The Overseas Territories have provided formal written confirmation of the factual accuracy of the relevant parts of our reports.

2.4.4 **Regulatory arbitrage**

Regulatory arbitrage is the selection of a jurisdiction of operation on the basis of the regulatory legislation and structure in place. Regulatory arbitrage tends to result in persons who, for their own reasons, wish to avoid regulation, selecting less-regulated jurisdictions. Consequently, less-regulated jurisdictions often become a target for money launderers and fraudsters.

All the jurisdictions have expressed a commitment to achieve the required international standards in financial services regulation envisaged by the White Paper. We consider that it should be recognised that other offshore centres, not being part of the Caribbean Overseas Territories and Bermuda, who also provide financial services and who may be regarded as competitors of the Overseas Territories, may not share the same level of commitment.

To prevent the possibility of regulatory arbitrage, even on a short-term basis, the adoption of international standards should be seen as a global issue and not simply one of relevance to the Overseas Territories. Therefore, other jurisdictions should be encouraged to ensure that they introduce similar improvements and thereby facilitate a level playing field between jurisdictions.

The work of groups such as the Financial Stability Forum in raising global standards will be of importance in this area and should continue to receive strong support from both the UK and the Overseas Territories.

2.4.5 **Scope limitations and other related matters**

Our terms of reference do not provide for us to verify all the factual matters in this report, which would be a major and time consuming task. Instead, as agreed with the Steering Committee and set out in the TOR, we asked the Overseas Territories to provide us with information (including copies of relevant legislation) and to check various drafts of our reports for factual accuracy. This they have done. It should be appreciated that any further information not provided to us might alter our conclusions.

In a number of instances, sector information (for example total funds under management and analyses of a jurisdiction's main sources of business) is not collated by the jurisdiction and therefore was not available to us. In other cases available information is dated.

There was also, on occasion, a lack of available statistical information, particularly in relation to co-operation provided by the Overseas Territories to other jurisdictions. It appears that either this information is not available in a format that is retrievable to provide the statistics necessary, or it is not kept at all. The absence of such information has made certain comments on the level of co-operation provided by the Overseas Territories impossible to verify or refute. Recommendations to resolve this matter have been made in the report.

This report has been prepared for the sole purposes of a review of Financial Regulation in the Caribbean Overseas Territories and Bermuda for the Steering Committee comprising representations from the Foreign and Commonwealth Office, HM Treasury, Financial Services Authority and Governments of Bermuda, Cayman Islands and Anguilla ("the client"). It has been designed to meet the agreed requirement of the client and particular features of the engagement of KPMG determined by the client's needs at the time. This report should not therefore be regarded as suitable to be used or relied on by any person or organisation other than the client or for any other purpose or in any other context. Any person or organisation other than the client who chooses to rely on this report will do so at its own risk. KPMG will accept no responsibility or liability in respect of this report to any third party.

2.4.6 **Timescales**

Whilst we have noted areas where we consider action is required as a priority we have not set out specific timescales. We consider that the precise timescales are best determined bilaterally between the individual overseas territories and the Foreign and Commonwealth Office.

2.4.7 **Acknowledgements**

We are most grateful for the significant amount of time spent by representatives of the Overseas Territories, Her Majesty's Government and the other organisations whom we met.

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Prepared 27 October 2000

3 Regulatory authority

3.1 Introduction

As stated in the White Paper, a sound, transparent regulatory environment is necessary to maintain investor confidence and the reputation of the financial sector in a particular jurisdiction. This is only possible if the regulatory authority is, and is seen to be, independent.

In order to demonstrate this 'independence', the jurisdiction must be seen to meet international standards. These standards extend beyond simple independence to encompass such issues as resourcing and accountability. This theme is developed further below.

Our terms of reference cite four documents which provide specific details on what the international community expects from a regulatory authority. These documents are:

- Objectives and Principles of Securities Regulation issued by International Organisation of Securities Commissions ("IOSCO");
- Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision ("Basel");
- The Supervision of Cross-Border Banking by Basel and the Offshore Group of Banking Supervisors ("OGBS"); and
- Insurance Principles, Standards and Guidance Papers by the International Association of Insurance Supervisors ("IAIS").

These documents consider all aspects regarding the regulatory authority including licensing, supervisory and enforcement powers and the ability of the authority to co-operate with other regulatory and legal bodies.

In addition, the Guidance Notes introduce several concepts which are not explicitly referred to in the documents above but which are included in the scope of our review.

International co-operation and the powers of the regulator pertaining to the different financial sectors in the jurisdiction are dealt with elsewhere in this report.

This section deals solely with the consideration of the remaining principles relating to the regulator. The Supervision of Cross-Border Banking and the Insurance Principles, Standards and Guidance papers do not refer to this subject and, as such, their content has been excluded from this discussion.

3.2 Principles relating to the regulator

The following section sets out the criteria underpinning what constitutes a regulatory authority which is deemed to meet acceptable international standards and the implications for the jurisdictions under review.

The source of the information set out in this section is Basel principle 1, IOSCO principles 1 to 5 and the Guidance Notes.

The regulatory authority should have clearly defined responsibilities, be operationally independent and accountable, have adequate powers and resources, be consistent in its approach and observe the highest professional standards including upholding appropriate standards of confidentiality.

- Clear responsibilities

Ideally the responsibilities of the regulator should be set out in law and adequate legal protection should be provided to the regulatory authority and its staff. Legislation should be designed to avoid gaps or inequities in regulation.

- Independence and accountability

The regulator should be operationally independent from external political and commercial influence and be accountable in the use of its powers and resources. Independence is deemed to be enhanced by a stable source of funding and would be considered to be compromised by any marketing activities carried out. Approval of decisions made by the regulator, by the government or a minister does not necessarily constitute a lack of demonstrable independence providing any such consultation does not include decision making on regulatory matters.

- Powers and resources

The regulator must have adequate powers and the capacity to exercise its powers, including licensing, supervision, inspection, investigation and enforcement. In many cases these powers vary across the financial sectors represented in the jurisdiction and therefore these are considered in the relevant sections of this report.

In order to exercise its tasks, the regulator must be adequately funded with the level of funding reflecting the difficulty of retaining experienced staff. Training should be provided as required on an ongoing basis.

- Clear and consistent processes

The processes adopted by the regulator should be comprehensible, transparent, fair and equitable and consistently applied. On policy decisions, the regulator is expected to consult with those who may be affected; it is generally desirable to make public disclosure of policy. The regulatory authority should also play an active role in the education of financial service industry participants.

- Staff conduct

Staff of the regulator are expected to observe the highest professional standards and be given clear guidance on conduct matters including on conflicts of interest, use of information obtained, fairness and the observance of confidentiality provisions.

3.3 **Self-regulation**

IOSCO principles 6 and 7 advocate the use of self-regulatory organisations ("SROs") in appropriate circumstances, providing the SROs are subject to the continuous oversight of the regulator and observe similar standards of conduct to the regulator itself.

3.4 **Factual assessment**

3.4.1 **Introduction**

There are two bodies responsible for financial service regulation in the Cayman Islands. These are the CIMA and the Stock Exchange Authority (the "Authority").

CIMA is responsible for the day-to-day supervision of banks, trust companies, mutual funds, mutual fund administrators, insurance companies, managers, brokers and agents and company managers. It is also responsible for the management of the Cayman Islands currency.

The Authority is responsible for the regulation of the Cayman Islands Stock Exchange. The Authority has no full-time staff and its supervisory activities are limited to monthly reports provided by the CSX and review of the CSX annual report before it is tabled in the Legislative Assembly. The Authority also has to review and approve any rules that the CSX wishes to introduce. The oversight of the CSX is dealt with in section 3.6.

3.4.2 **Clear responsibilities**

3.4.2.1 ***Constitutional position***

The authority to license regulated financial institutions (other than Mutual Funds) is vested in the Governor in Council (that is, Executive Council of the Cayman Islands Government).

All applications however are processed by CIMA to ensure compliance with the requirements of the law and regulatory policies. The approval and issuance of the licences are therefore based on recommendations of the CIMA.

3.4.2.2 ***Regulatory structure***

CIMA is a statutory agency created by the Cayman Islands Government through the Monetary Authority Law ("MAL").

The mission statement of the CIMA requires it to:

- regulate and supervise the financial services industry in order to maintain a first-class financial system;
- safeguard the interests of depositors, trust beneficiaries, policyholders and mutual fund investors from undue loss;
- contribute to public confidence in the financial system by promoting sound corporate governance, prudent business practices and compliance with laws and regulations; and
- promote and maintain monetary stability and preserve the value of the Cayman Islands currency and advise the government on banking and monetary matters.

CIMA is organised into the following departments:

- Banking and Trust;
- Investment Services (covering collective investment schemes and company management);
- Insurance;
- Policy and Research;
- Currency Operations; and
- Administration.

3.4.2.3 ***Gaps in regulatory coverage***

Though there is legislation governing the Co-operative Credit Unions and Building Societies, these non-bank financial institutions and money transmitters are not covered under CIMA regulatory regime. Legislation is currently being drafted to bring these non-bank financial institutions under CIMA.

In addition, a Securities and Investments Bill is currently being drafted to cover securities and investment brokerage activities. Organisations carrying out such business are, in many cases, licensed by CIMA in another capacity, or are members of the CSX.

3.4.2.4 ***Immunity***

Section 37 of the Monetary Authority Law provides that neither CIMA, nor any director or employee of CIMA, shall be liable in damages for anything done or omitted in the discharge or purported discharge of their respective functions under the Law unless it is demonstrated that they acted in bad faith.

3.4.3 **Independence and accountability**

3.4.3.1 ***Accountability***

CIMA is accountable to the Government of the Cayman Islands, by virtue of the fact that it is a creature of statute and that the Governor in Council appoints its board of directors, also it is funded by the Government. In this respect, CIMA issue audited financial statements on an annual basis that are available to the public. The 31 December 1998 Annual Report and Financial Statements was issued on 12 April 2000.

3.4.3.2 ***Marketing responsibilities***

CIMA has no marketing responsibilities. Marketing of financial services in the islands is carried out directly by Government and also by trade associations. CIMA may attend conferences with trade associations and provide technical expertise to the associations and Government. However, CIMA do not see this role as marketing the jurisdiction.

3.4.4 **Powers and resources**

3.4.4.1 ***Introduction***

Those parts of the Guidance Notes which relate to powers and resources pertaining to international co-operation and the powers of the regulator in respect of the different financial sectors in the jurisdiction are dealt with in the sector specific sections of this report.

3.4.4.2 ***Staffing***

From discussion with various departments within CIMA and from review of their recently updated organisation chart, which introduced a number of newly created positions, it is clear that CIMA is currently under-resourced. The budgeted staff complement as at April 2000 was 67 with CIMA was looking to fill 17 vacant positions including the Managing Director (now filled by an experienced regulator with international experience), Head of Banking and Trusts and the new post of Deputy Head of Policy and Research.

Over the past two years, the turnover of staff has been relatively high and it has proved difficult to recruit staff with the required experience. Staff turnover at CIMA reflects the industry norm which is influenced by low unemployment and by the immigration laws of the Cayman Islands.

3.4.4.3 ***Source of income***

CIMA is predominantly government funded with other income being earned as investment income on the portfolio of assets forming the backing to the Islands' currency issue.

An annual budget is prepared by CIMA and approved by the Board of Directors and subsequently by the Governor in Council.

3.4.4.4 ***Licensing powers***

For banks and trust companies, company managers and insurance companies, the Governor in Council is responsible for issuing licences, under Section 5(1) of the Bank and Trust Companies Law, Section 4 of the Company Management Law and 4(2) of the Insurance Law, respectively.

Under the Mutual Funds Law Sections 3 and 4, CIMA has the authority to grant certificates of registration and mutual funds licences, providing it is satisfied that the statutory requirements are met. Under Section 11 of the Mutual Funds Law the Governor in Council retains the power to issue mutual fund administrators' licences.

It should be noted that the Governor in Council relies on CIMA for the provision of technical advice and regulatory judgement but retains the right to reject any such recommendations.

3.4.4.5 ***Investigation and enforcement***

Suspensions or withdrawals are decided by the Governor in Council, except in the case of mutual funds, where CIMA has revocation power (section 29(3)(a) Mutual Funds Law).

CIMA has the authority to require licence holders to provide information that it may require and may impose conditions on a licence. For minor breaches of regulatory matters, CIMA relies on "moral suasion" rather than formal enforcement powers, which has proved to be effective. CIMA has no authority to fine except in the case of late filing.

3.4.5 **Clear and consistent processes**

3.4.5.1 ***Involvement in legislative development***

The various industry-specific laws provide for CIMA to make recommendations to the Governor in Council on regulatory matters and legislative matters. Furthermore, if issues or problems are identified (internally or by external consultation processes) drafting instructions are given to the Legislative Drafting Section of the Attorney-General's Chambers. The draft may then be circulated to the industry for consultation, after which the Board of Directors of CIMA reviews the draft with any agreed amendments. The final version is passed to the Attorney-General before submission to the Governor in Council.

CIMA does have policy-making authority on matters such as points of interpretation, selection of standards eg Risk-Asset Ratio policy, and matters related to supervision and inspection.

3.4.5.2 ***Documented procedures***

CIMA does not have a procedures manual which covers licensing, off-site supervision and on-site supervision activities across all licence holders. There is a manual for on-site inspections which is a comprehensive document and could be used as a template for other activities and industry sectors together with an off-site monitoring manual for banking and a procedures manual for insurance.

3.5 Issues and recommendations

3.5.1 Introduction

By the creation of CIMA in 1996, the Cayman Islands commenced a positive process of developing a structured and resourced regulatory function with a visible commitment to international standards and good practice. We consider that CIMA, staffed as it is with a number of experienced and skilled regulators, some with international regulatory experience, provides a firm foundation for the attainment of those international standards with which it does not already comply.

There are a number of issues, however, where attention needs to be focused in order to meet those standards. Many of these, such as the operational independence of CIMA, are already being actioned by Cayman Islands but have not yet been resolved. The main areas for action are detailed below.

3.5.2 Regulatory independence

In our view operational independence means the ability of the regulatory authority to act in the best interests of regulation (systemic, national and protection of customers) free from political and private sector interference, (so avoiding the danger of regulatory capture) but with proper political accountability.

At present regulatory legislation normally vests licensing and enforcement power in the Governor in Council. Although we have no evidence to suggest that decisions are not made exclusively on regulatory grounds the potential exists for this to occur. Whilst this situation continues CIMA cannot meet international standards in respect of operational independence.

Representatives from the regulator accept that CIMA does not yet possess the necessary level of operational independence. A paper which outlines proposed changes to the way CIMA is run has been submitted to the Governor in Council. We understand that the proposed changes include:

- the provision for operational independence of CIMA;
- changes to the legislative framework;
- changes to the size and composition of the Board of Directors of CIMA;
- direct rule making powers for CIMA;
- financial independence for CIMA.

3.5.3 Resources

Our report details a number of areas where additional resources are necessary to meet the relevant international standards. These include the introduction or extension of on-site inspections and the enhancements to off-site supervision in a number of areas. The introduction of legislation to regulate those engaged in securities/investment business will exacerbate the current shortfall.

As a result of this, we consider that CIMA needs to significantly increase its resources. It is currently impossible to determine a precise headcount, given that much will depend upon the way in which CIMA undertakes these tasks. We support CIMA's decision to undertake a formal analysis of staff needs.

An increased programme of recruitment should therefore be commenced as soon as possible.

3.6 Oversight of the Cayman Islands Stock Exchange

We do not consider that the CSX, as an SRO, can be effectively regulated by a body with no full-time staff. Whilst there have been no regulatory issues arising from this deficiency, we consider that this situation clearly does not comply with international standards or good practice as there is no demonstration of the independence of the regulator in this capacity nor sufficient oversight of the SRO.

We consider, therefore, in order to meet international standards appropriate supervision of CSX must be instituted. This could be through transferring the supervisory functions to CIMA or by proper staffing and other resourcing of the Stock Exchange Authority.

We welcome your comments on this site.

Prepared 27 October 2000

4 Banking

4.1 Introduction

There are established international standards in place concerning the regulation and supervision of banking. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of banking conform to the standards outlined in the "Core Principles for Effective Banking Supervision" (the "Core Principles") produced by the Basel Committee on Banking Supervision ("Basel Committee"), together with the report by members of the Basel Committee and members of the Offshore Group of Banking Supervisors on the "Supervision of Cross-Border Banking".

The Core Principles comprise 25 basic principles required to be in place for a supervisory system to be effective. The Principles cover:

- preconditions for effective banking supervision (Principle 1);
- licensing and structure (Principles 2 to 5);
- prudential regulations and requirements (Principles 6 to 15);
- methods of ongoing banking supervision (Principles 16 to 20);
- information requirements (Principle 21);
- formal powers of supervisors (Principle 22); and
- cross-border banking (Principles 23 to 25).

The requirements relating to cross-border banking were developed by the report "Supervision of Cross-Border Banking". This detailed the requirements for effective home and host banking supervision in order to facilitate effective consolidated supervision including the associated necessary information flows between regulators.

Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against the above standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

4.2 Type and scale of activity

At present the banking sector in the Cayman Islands currently comprises over 450 banks from sixty-five countries around the world that hold assets of US$671 billion. Forty-three of the world's top fifty banks have a branch or locally incorporated subsidiary in the Cayman Islands.

Commercial banking in the Cayman Islands began in 1953 with the opening of a branch of Barclays Bank. It was not until 1963 that the second commercial bank, Royal Bank of Canada, opened. The first move in the development of an international banking centre came in 1966 with the enactment of the Banks and Trust Companies Regulations Law now superseded by the Bank and Trust Companies Law (2000 Revision) and the Banks and Trust Companies (Amendment) (Access to Information) Law, 2000. By 1972 there were 81 Banks and Trust Companies licensed and this increased to 324 in 1980 and 481 in 1985.

There are different types of licences which may be granted. These types are as follows:

Banking	254
Banking & Trust	190
Banking & Trust (Restricted)	2

Banking (Restricted)	12
Banking (Restricted) & Trust (Restricted)	3

Total	**461**
	====

Under the Banks and Trust Companies Law banking licences are issued in two categories. Category "A" licensees can conduct domestic banking business and offshore business; and Category "B" licensees can only conduct offshore business. There are currently 31 Category A banks and 430 Category B licence holders.

During the recent past the number of licences granted was as follows:

	Category A	**Category B**	**Total**
1997	-	17	17
1998	1	6	7
1999	2	11	13
2000 (to date)	-	8	8
	---	---	---
	3	42	45
	====	====	====

4.3 **Factual assessment**

4.3.1 **Legislation**

The Banks and Trust Companies Law (2000 Revision) ("BTCL") governs banking regulation and assigns supervisory responsibility to CIMA. Under the BTCL, certain powers are preserved by the Governor in Council and, in these cases, CIMA provides recommendations for the Governor in Council to endorse or refuse.

Banks wishing to carry on banking business in or from within the islands must apply for and receive a licence from the Governor in Council.

The BTCL covers areas such as:

- granting, surrender and revocation of banking licences;
- minimum net worth for licensee;
- control of changes in ownership of shares in a bank;
- control of the use of specified words (eg bank) in a name;
- control of appointment of directors;
- duties of CIMA in relation to the regulation of banking business;
- duties of a licensee;
- ongoing supervision of licensees;
- enforcement powers.
- powers of the Governor in Council;
- immunity in respect of activities undertaken in the exercise of powers under the BTCL.

The Monetary Authority (Amendment) (International Cooperation) Law 2000 ("MAICL") and the consequential amendment to the BTCL, the Banks and Trust Companies (Amendment) (Access to Information) Law 2000 ("BTCAIL") enable CIMA to access client information and exchange client information with overseas regulatory authorities, the latter under certain

conditions (see Section 14 of this Report for details).

The MAL (1998 Revision) deals with the overall mandate and functions of CIMA. It is also the legislation that ascribes statutory immunity to CIMA and its employees, subject to the usual "in good faith" test.

4.3.2 **Regulations**

There are two relevant sets of regulations in the jurisdiction:

4.3.2.1 ***The Banks and Trust Companies (Licence Applications and Fees) Regulations (1998 Revision)***

These regulations stipulate the documentation that is to be submitted with each application for a licence. As part of the application information on all shareholders with more than two percent of the licensee's share capital must be provided to CIMA.

They also provide the legal authority underpinning the necessity for an applicant to satisfy CIMA that all directors, managers, and officers of the bank are of good character and have committed no criminal offences. Applicants must provide evidence acceptable to CIMA that they have adequate professional knowledge and experience in the banking business.

4.3.2.2 ***Banks and Trust Companies (Designation) Order (1997 Revision)***

This order designates the Financial Secretary to exercise the powers of the Governor in Council to approve the issue, transfer or disposition of shares in a licensee under the BTCL, where there will be no change in the control or ultimate beneficial ownership of the licensee. In addition the applications are processed by CIMA to ensure that the aforementioned criteria is met and approval is granted based on the recommendation of CIMA.

4.3.3 **Guidance Notes**

Guidance notes on licensing requirements and procedures have been issued.

CIMA has also issued guidance notes to the industry for completing the basic prudential financial return (the BS Form) and accompanying schedules. These cover:

- risk weighting of assets in accordance with Basel guidelines;
- the accounting treatment of investments in subsidiary/affiliate banks;
- the reporting of unrealised gains/losses on investment securities;
- the definition of director;
- large exposures;
- liquidity;
- security investment valuations; and
- the accounting treatment of past due loans, non-accrual loans, and restructured loans.

Guidance notes on a number of topics, for example sound risk management practices, good practices for derivatives and other off-balance sheet instruments do not currently exist. Instead CIMA relies on Basel principles for guidance and refers the industry to the appropriate principle to ensure that good practices are followed.

4.3.4 **Supervision - systems and procedures**

4.3.4.1 ***Regulatory structure***

As stated in 4.3.1 above the day-to-day supervisory responsibility of banks rests with CIMA. Decisions relating to licensing and disciplinary action ultimately rest with the Governor in Council to whom CIMA makes recommendations.

Within CIMA a specific department is responsible for banking supervision, however the post of Head of Bank Supervision is currently vacant. There is a Deputy Head of off-site supervision who is currently supported by three Senior Analysts and five analysts and a Deputy Head of on-site supervision who is supported by one Senior Analyst and three Analysts.

Employees systematically attend relevant training courses and have attended formal training sessions sponsored by the Federal Reserve, the FDIC, Financial Services Authority, Office of the Controller of the Currency, the Financial Stability Institute, the Bank for International Settlement and regional central banks. Staff have also been seconded to the Office of the Superintendent of Financial Institutions, the Bank of England and local commercial banks.

Additionally CIMA seeks to ensure that each of the senior officers attends two seminars/conferences annually. CIMA sends its senior bank regulatory personnel to meetings of the International Group of Bank Supervisors, the Caribbean Group of Bank Supervisors, the Offshore Group of Bank Supervisors and the Association of Supervisors of Banks of the Americas.

4.3.4.2 ***Licensing***

The Cayman Islands operate a licensing policy under which licences are only granted to banks:

- which are subject to effective consolidated supervision by a regulator in another jurisdiction, considered by CIMA to be reputable; and
- where the total capital of the group to which the bank belongs is greater than US$50 million.

As part of the licensing process CIMA requires all applicants that are part of an established banking group to provide confirmation from their home regulatory authority:

- that it has no objection to the proposed Cayman Islands entity; and
- that the proposed licensee will be included in the consolidated supervision of the parent.

At present limited evaluation is undertaken of the capacity of the regulator in that jurisdiction to effectively undertake consolidated supervision.

If the prime shareholder is a corporate body, the latest annual report including audited financial statements must be submitted to CIMA for review. If the shareholders are individuals, they would be required to submit:

- a personal questionnaire;
- a police clearance certificate; and
- bank and character references.

Background checks are also performed by CIMA with the assistance of the Financial Reporting Unit of the Royal Cayman Islands Police. A full vetting check is extended to non-executive directors and shareholders.

Prior approval of CIMA is also needed for a licensee to establish a branch, subsidiary, agency or representative office outside of the Cayman Islands. CIMA reviews the proposed business plan for the institution's ability and capacity to undertake any expansion.

4.3.4.3 ***Off-site supervision***

Locally incorporated banks and those branches of overseas banks with a physical presence in the Cayman Islands is required to submit quarterly returns on the BS forms and schedules, providing details of the balance sheet, off-balance sheet, profit and loss account, large exposures, derivative contracts, maturity (i.e. liquidity position) schedules, and past due reports. Branches without a physical presence are currently required to submit annual returns only although CIMA have advised us that this is being increased to twice yearly.

Annual audited accounts by approved auditors are also required.

CIMA performs a detailed financial analysis of all of its licence holders. The analysis covers the adequacy of capital and its composition, asset quality, large exposures, off balance sheet exposures, foreign exchange deposit concentration, earnings and liquidity. The majority of banks are now submitting their BS data via e-mail or on a diskette.

Officers from CIMA also meet on a regular basis with senior officials from licence holders. Where a meeting has not occurred for some time a formal request is made. There is however no annual prudential meeting with the licence holder and its auditor in respect of all licence holders.

4.3.4.4 ***On-site inspections***

CIMA have carried out 31 inspections since the programme began in 1998, covering twelve Category A banks and nineteen Category B banks.

The on-site inspections review risk-based activities with the programme primarily driven by the findings of off-site supervision. To date the inspections have focused on systems and controls and the review of the key risk areas as well as the institution's management of those risks.

Under the BTCL and the MAICL CIMA is able to review asset and loan files and now has access to review individual client files. Until these recent legislative changes occurred such a capability was not present in the absence of client consent or a court order.

On-site tests concern, *inter alia*, the adequacy of and compliance with internal policies and procedures, segregation of duties and asset quality. We are advised that CIMA also carries out checks on licence holders' anti-money laundering procedures.

CIMA's plan is to review all institutions for which it is the sole supervisor and those which have a physical presence in the islands. The strategy to date has been to:

- benchmark and ascertain good practices for banking operations within the Cayman Islands;
- to move on to the inspection of banks having a high risk profile with emphasis on those institutions for which CIMA is the home country regulator;
- to subsequently extend the on-site work to banks which maintain their books and records outside of the Cayman Islands; and
- to include trust companies as part of the inspection programme.

It should be noted that CIMA undertook on-site inspections in a number of Central American nations last year including Costa Rica, Nicaragua and Panama. The visits were managed without the need for a preliminary Memorandum of Understanding ("MOU").

We have been advised by CIMA that on two occasions, the findings of an on-site inspection have been instrumental in closing down mismanaged banks.

4.3.4.5 ***Ongoing requirements***

Books and records

All banks are required to maintain proper books and records in accordance with accepted international accounting standards. It is a requirement that all licensees report to CIMA on a regular basis, and auditors approved by CIMA must audit the financial statements of the banks on an annual basis, providing an opinion on the licensees' systems and controls which would include record keeping.

The BTCL and the new MAICL give CIMA access to the books and records which now include individual client files

Whilst Category A banks must maintain books and records in the Cayman Islands there is no legal requirement for Category B banks to retain records in the jurisdiction. A number of "B" licence-holders have neither books and records nor mind and management in the Cayman Islands. We are advised that in other instances the Principal Office does maintain duplicate books and records. As stated in 4.3.4.4 above CIMA has undertaken a number of on-site visits to the jurisdiction where the records and mind and management are located.

Authorised Agents and Principal Office

All banks are required to have a principal office, and two individuals or a company located in the Cayman Islands as authorised agents. Both the principal office and the authorised agents must be approved by CIMA.

Unless a licensee maintains a local office with resources acceptable to CIMA, it is a requirement that the functions of an authorised agent are carried out by Category "A" licensees with the necessary resources and local industry expertise and that are in good standing with CIMA. At the time of licensing CIMA approve both the Principal Office and the Authorised Agent and CIMA's prior approval is required to change either.

Capital Adequacy

The reporting framework for capital adequacy is based on the Basel risk based rules.

The jurisdiction requires a risk-adjusted ratio of at least 12% compared with the recommended minimum of 8%. Private banks and affiliate institutions must maintain a minimum risk-adjusted ratio of 15%.

Derivatives/off balance sheet instruments

Banks engaged in derivatives and other off balance sheet instruments are expected to have appropriate policies and procedures in place. On-site work evaluates these policies and procedures. Derivatives and off balance sheet reporting is a systematic part of quarterly and annual BS reporting to CIMA. Balance sheet conversion factors are used to bring these items to a balance sheet equivalent figure.

Anti-money laundering

Licence holders are subject to the anti-money laundering legislation and Code of Practice, which covers, *inter alia*, "know your customer" requirements.

Although section 30 of the MAL, as amended by the MAICL, requires CIMA to monitor compliance with the Money Laundering Regulations 2000, the breach of those regulations by a licence holder is not, in itself, a ground for enforcement action. However, CIMA considers that a licensee carrying on banking business in breach of the regulations would be liable to disciplinary action as this would be carrying on business contrary to the public interest.

Dedicated compliance resources

As a part of its ongoing supervisory process, CIMA has articulated the need for licensees to have dedicated compliance officers and regular money laundering training. We are advised by CIMA that to date, at least 30 institutions have dedicated compliance officers and staff training courses are conducted by the financial industry on a regular basis.

4.3.4.6 ***Parallel banks***

The Cayman Islands has not since 1983 licensed banks with sister or parallel banks in other jurisdictions and are encouraging existing banks to change their shareholding structure to facilitate consolidated supervision. There remain 31 such banks from a wide variety of regulatory jurisdictions, many in Latin America.

CIMA has recognised the risk of contagion caused when problems associated with a sister bank could lead rapidly to a massive withdrawal of funds and have advised us that restrictions have been placed on parallel banks in respect of intra group and related transactions.

CIMA also requires that the Cayman Islands entity uses the same auditing firm as the other affiliate banks in the group.

4.3.5 **Enforcement - systems and procedures**

CIMA's enforcement powers include the following:

- licence revocation and application to the Court for winding up;
- imposition of (further) conditions;
- require the substitution of any director or officer of the licensee;
- appoint an adviser to or controller of the licensee; and
- require the licensee to take such action as deemed necessary.

Under Section 12(1)(b) and (4) of the BTCL, CIMA also has power to appoint an independent auditor to conduct a review.

CIMA however lacks specified formal authority of direction and therefore cannot, for example, instruct a parallel bank to change its group structure. However, CIMA can, in certain defined circumstances, through the Governor in Council impose conditions or "cease and desist orders" and moreover, is able to take any other action it considers necessary.

CIMA has power to "police the perimeter" by investigating potential unlicensed banking activity and take appropriate action.

Under Section 12 (3)(b) of the BTCL it has power to request any information, matter or thing from someone believed to be carrying on unlicensed banking business. It may also, with the approval of the court, take such action as it considers necessary to protect depositors.

4.3.6 **International co-operation/co-ordination**

Section 42 (3) of the MAL provides a gateway under which CIMA can pass information relating to licence holders to the regulators in other jurisdictions for the purposes of consolidated supervision. Further, it is now a function of CIMA to assist overseas regulatory authorities.

This ability is subject to subsection 42(4) which previously limited disclosure relating to customers other than information relating to large credit exposures of the licensee. However, the MAL, as now amended by the MAICL, allows CIMA to pass information relating to licence holders to regulators in other jurisdictions for the purposes of exercising regulatory functions including the conduct of civil or administrative investigations and proceedings to enforce laws, regulations and rules administered by that authority.

A number of foreign regulatory bodies have carried out or commissioned reviews of Cayman Islands licensees for the purposes of consolidated supervision. Examples include regulators from the UK (in process), Isle of Man, Brazil and Switzerland.

The Cayman Islands have been working on a standard MOU document that can be used as a model to govern all future relations between the Islands and other regulatory jurisdictions and, in particular, set out the terms, conditions and conduct of on-site inspections.

An MOU has been signed between CIMA and the Central Bank of Brazil, granting the Brazilian regulator the right to undertake an inspection in the Cayman Islands.

We are advised that information received from a foreign regulator is protected by the Confidential Relationship (Preservation) Law as well as the MAL from further disclosure.

4.3.7 **Depositor protection schemes**

The Cayman Islands does not have a formal depositors' protection scheme. However, the Second Schedule of the Companies Law (1998 revision) provides for depositors to be classified as preferred creditors in the event of the liquidation of a licensee under the BTCL. Deposits of up to $20,000 receive precedence of priority in the event of a bank winding-up.

4.4 **Issues and recommendations**

4.4.1 **Introduction**

The Cayman Islands have demonstrated a proactive approach to bank supervision, both generally and particularly in the area of Category "A" (domestic) Banks, and over recent years have significantly increased the quality of its banking supervision. This progress is particularly welcome given the importance of the Cayman Islands as a banking centre.

However, CIMA is aware that there are a number of areas of banking supervision, particularly in respect of Category B banks where additional action is needed in order to fully meet the requirements of international good practice as laid down by the Basel Committee. The areas where attention is necessary are detailed below.

In addition to these, as CIMA does not have true operational independence, it cannot comply with Basel Core Principle 1. This has been discussed in a previous section to this report and is therefore not repeated here.

4.4.2 **Access to and sharing of information**

Previously the provisions of the MAL only allowed exchange of information relating to the bank itself and in respect of large exposures. This allowed CIMA to co-operate on a number of supervisory matters, in particular those that would have a material effect upon the stability of a bank.

Nevertheless previous confidentiality provisions in the MAL caused the Cayman Islands to fail the requirements of the Basel Cross-Border Supervision paper. We therefore welcome the recent amendments to the legislation that allows for enhanced information sharing with other regulators, as contemplated by the Basel paper. It is important that the change in legislation operates effectively in practice and we are advised that CIMA is developing procedures to maintain a full record of information requests and the response provided to monitor this.

The effective regulation of banks on a consolidated basis relies upon the regular interflow of information between regulators in different jurisdictions. Given the leading role the Cayman Islands plays in offshore banking CIMA should rapidly enhance its relationship with other jurisdictions, whether through MOUs or otherwise so enabling the sharing of information pertinent to consolidated banking supervision.

We recommend that the model MOU referred to in 4.3.6 above is completed as soon as possible and that CIMA is given authority to enter into MOUs without prior approval of the Governor in Council. CIMA should then commence a proactive programme of seeking to enter into formal arrangements with relevant foreign regulators so establishing a mechanism for the flow of regulatory information.

4.4.3 **Off-site supervision**

In general we consider the off-site supervisory approach to be thorough and well documented.

We understand that CIMA has started to request submission of the BS form on a semi annual basis from those entities previously only required to do so on an annual basis. However, we recommend that all licence holders should be required to submit quarterly returns to CIMA, in order to ensure that regular up-to-date information is available to assist in supervision of all entities.

This is relevant even where the licence holder is believed to act as a "booking agent" for its parent institution as such information would provide CIMA with an ability to identify where the activities of a licence holder were varying from previous trends. It will also help CIMA to assist in the consolidated supervision of the institution.

All banks should be requested to maintain, document and submit on a regular basis up-to-date business plans. This will enable CIMA to ensure that it is kept appraised of the current and proposed operation of the bank, outside of prudential meetings, periodic requests or voluntary filings.

4.4.4 **On-site inspection**

Given the number of licensed banks in the Cayman Islands we consider that the number so far visited is too low (less then 10% of banks have been visited). The number of such visits, particularly to those that have no books and records in the Cayman Islands ("cubicle banks" — colloquially known as "brass plate banks") should be significantly increased.

We consider that CIMA should extend its review programme with the aim of visiting all banks with regulatory concerns on at least an annual basis and other banks (depending on size, risk and whether CIMA is the main or sole regulator) on between a two to five year basis.

We regard the implementation of this process to be a key priority and recommend that it should be commenced by the end of December 2000

We further believe that it is unlikely that this can be achieved without significant additional resources in the inspection function and therefore recruitment in this area must also be considered a priority. The issue of resources is covered in Section 3 of this report.

The resource requirement is particularly acute in the case of cubicle banks as this will require inspection to be undertaken outside the Cayman Islands. If CIMA is unable to make such a resource commitment the only alternative to meet international requirements would be to require physical presence in the form of locally accountable management along with commensurate records. However, even if this route is followed, there would still be a requirement for on-site visits to review the operational aspects of the business and ensure that the books and records being maintained in the Cayman Islands is accurate and up to date.

Whilst we accept the important role of the auditor we do not consider that CIMA can be satisfied that all banks maintain adequate records without regulatory on-site supervision particularly of Category B banks who choose not to maintain records in the Cayman Islands. Such a process would be required to fully comply with Basel Core Principles 16 and 21 and verifying banks' compliance with other Core Principles.

4.4.5 **Ongoing requirements**

We consider that, in respect of capital adequacy, the forms and accompanying notes required for completion by licence holders are comprehensive and are comparable in quality to those issued by other regulatory regimes.

In the case of liquidity assessment there is scope for the time bands (for assigning assets and liabilities according to their remaining period to maturity) to be improved in line with international practice. This is because if liquidity is a problem for a bank, it is likely to be within these shorter duration time bands.

At present, the first band covers assets and liabilities from sight to 90 days maturity. In our view, this first band should be divided into three separate time bands of sight to seven days, seven days to 30 days and 30 days to 90 days.

4.4.6 **Role of the Auditor**

There is currently no provision within the BTCL providing a gateway for the auditor to disclose information on a licence holder to CIMA nor is there an obligation imposed on the auditor to report certain matters or events to CIMA.

We consider that a duty of reporting combined with an exemption from the general duty of confidentiality in such reporting would be valuable and therefore recommend that it should be included in a revision to the BTCL. It is noted, however, that under the MAICL, CIMA may require a person reasonably believed to have information relevant to its regulatory enquiries to provide such information.

Additionally there should be annual prudential meetings with the auditor and licence holder for all Category A licence holders and all Category B licence holders with a physical presence in the Cayman Islands. In the case of those licence holders without a physical presence a meeting with the auditor should form part of the on-site inspection.

These meetings should cover, *inter alia*, development of the bank's business plan, issues relating to the bank's financial position and how the banks are covering regulatory developments.

4.4.7 **Depositor protection**

The Cayman Islands has instituted a programme to first pay out deposits of less than $20,000 if funds are available upon the wind-up of a bank. CIMA represent that neither they nor their licence holders portray the programme as a depositor protection scheme.

Whilst it is a matter for the Cayman Islands to determine what scheme, if any, they consider is appropriate, we consider the system in operation to be of limited value as it is dependent upon the insolvent bank having sufficient assets to pay its preferred creditors. This is by no means certain and therefore the scheme lacks the certainty needed to ensure adequate depositor protection.

4.4.8 **Consolidated supervision**

We are advised that CIMA does not encourage applications from countries with underdeveloped systems and inadequate supervision. CIMA does however rely upon the ability of foreign regulators to undertake consolidated supervision in a significant number of cases. It is therefore important that it is able to satisfy itself that such supervision is being undertaken effectively.

We therefore recommend that CIMA should, as a priority, undertake a review of the jurisdictions where it is relying upon a foreign jurisdiction exercising consolidated supervision. In doing so, focus should be placed on those jurisdictions which are not members of the Basel Committee.

4.4.9 **Parallel banks**

CIMA has taken a number of steps to reduce the risks associated with parallel banks and these are detailed above.

Paragraph 41 of the Basel Cross-Border Supervision paper addresses the question of parallel banks. The paragraph calls for "enforcing a change in group structure" to enable consolidated supervision.

However well regulated the Cayman Islands institution may be and whatever restrictions are placed upon it there remains the risk that the problems of parallel banks in poorly supervised jurisdictions could spread to the Cayman Islands licensed bank through temporary lending or investment of funds arrangements.

Therefore, to supplement its current initiatives, we recommend that CIMA should undertake an assessment of the parallel bank regulators on an ongoing basis, in particular as to whether the other jurisdictions fully subscribe to Basel principles and standards. Where parallel banks in other jurisdictions are considered to be poorly supervised, CIMA should take steps to compel its licensed bank to alter its corporate structure to enable the group to be properly supervised.

In order to do this, CIMA should have the legislative power to require changes in the corporate structure of its licence holders.

4.4.10 **Authorised agents**

Given the importance of the authorised agent, particularly when it is the representative of a licence holder with no mind and management in the jurisdiction and is therefore the first point of contact for the regulator, it is important that they are competent to undertake the role and are exercising proper diligence in their task.

We consider that CIMA should issue a formal code to authorised agents detailing what is expected of them in the undertaking of their duties. In addition we consider that CIMA should undertake reviews of authorised agents to verify compliance with this code.

The code should cover, *inter alia*:

- what information about the bank the agent is expected to have;
- what ongoing due diligence checks and other monitoring the agent should undertake;
- duties of reporting to CIMA; and
- duties relating to any other services provided by the agent (eg directors).

4.4.11 **Guidance notes**

We are encouraged by CIMA's use of guidance notes. We recommend that this is extended to the production of guidance on those areas where licence holders are currently simply referred to Basel Principles.

4.4.12 **Anti-money laundering**

Whilst we accept that, for regulatory supervision purposes, a breach of the anti-money laundering code could be considered "carrying on business contrary to the public interest" we consider that, to make the position absolutely clear, a breach of any anti-money laundering laws, codes, guidance or regulations should formally be express grounds for disciplinary action against a licence holder, including possible revocation of its licence.

4.4.13 **Enforcement powers**

CIMA is aware of the limitations in its enforcement powers in relation to minor regulatory breaches and that as a result Basel Core Principle 22 is not being fully complied with. It has compiled a list of desirable additions for consideration under future legislative revisions.

We therefore recommend that the BTCL is amended, at an early opportunity, to provide CIMA with the power to make directions and issue cease and desist orders.

4.4.14 **Application process**

The BTCL does not formally require fitness and probity checks to be undertaken in assessing a licence application. The only conditions imposed are that the applicant is qualified to carry on banking business and that the application is not against the public interest.

The Banks and Trust Companies (Licence Applications and Fees) Regulations (1998 Revision) specify the information and documentation that must be provided on an application for a licence under the BTCL. Requirements cover, *inter alia*, character references, police clearance certificate, evidence of good financial standing of each shareholder and evidence of adequate professional knowledge. While section 5 of the BTCL prescribes the information required by referring to the regulations, we recommend, a revision to the BTCL which places the obligation of being "fit and proper" on a stronger statutory footing.

We welcome your comments on this site.

Prepared 27 October 2000

5 Insurance

5.1 Introduction

The International Association of Insurance Supervisors ("IAIS") has produced a number of principles and standards set out in a series of papers and approved by its members.

These standards recognise that the regulatory framework for insurance supervision varies from country to country and are not mandatory and do not necessarily reflect current practice in all of the member countries. The principles and standards are intended to represent a target for supervisors to work towards and can be implemented in a flexible manner depending upon the circumstances of each jurisdiction.

The Offshore Group of Insurance Supervisors ("OGIS") has also introduced a set of principles, standards and guidance notes upon which self-assessment is required. Conditions of membership of this group include having legislation in place which enables its regulatory authority to adequately supervise insurance business by having the necessary resources and properly qualified supervisory personnel to enforce the legislation. Of the territories under review, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of OGIS, with Anguilla having observer status.

The Terms of Reference for this review require us to assess performance against International Standards and Good Practice in the insurance sector.

It is against these standards that we have made our assessments. The areas where it is considered that development may be required are contained in the issues and recommendations section of this report.

5.2 Type and scale of activity

Insurance company licenses are issued in two classes:

"A" in respect of domestic business (Cayman Islands risks); and

"B" for all other business (loosely defined as captive insurance).

The Cayman Islands Life Assurance market comprises 17 companies. Their 1998 business is summarised as:

US $ million	Life	Health	Annuity & other
Gross premiums	11.0	18.8	2.2
Net earned premiums	9.0	16.8	1.6
Net claims paid	3.2	14.8	0.4
Move in claims reserves	1.4	1.6	-
Total net income	(0.5)	(2.0)	1.7

The Cayman Islands domestic general insurance market comprises 14 companies. Their 1998 business is summarised as:

US $ million	Property	Motor	Liability/casualty	Marine & aviation
Gross premiums	22.3	9.8	2.2	0.4
Net earned premiums	5.6	8.8	1.8	0.2
Net claims paid	1.5	5.3	0.4	-
Move in claims reserves	3.0	(0.9)	0.1	-
Total net income	(0.1)	2.8	1.0	0.2

The Cayman Islands is the second largest captive centre in the world. Captives are regulated as Class "B" licensees and are classified (as at March 2000) as follows:

Category	Number
Pure captive	302
Association captive	89
Group captive	32
Open market insurer	24
Alternative financing vehicle	22
Segregated portfolio company	21
Rent-a-captive	12

	502
	====

Premium data for class B licences, based on information available for 1999, is as follows:

US $ million	
Gross premiums	2,700
Net income	522
Total assets	13,100
Net worth	3,800

CIMA reviews all captive insurance businesses to ensure that there is genuinely an element of insurable risk involved in their arrangements. Whilst there are no specific standards for captives, captive insurance companies are subject to the same international standards and good practice as those applying to general insurance companies.

There are 26 licensed insurance managers representing the captive insurance companies, and 22 insurance brokers involved in international and domestic insurance and reinsurance.

5.3 **Factual assessment**

5.3.1 **Legislation**

The Insurance Law (1999 Revision) ("the IL") governs the insurance regulatory regime in the Cayman Islands. CIMA undertake the supervision of insurance business. Under the IL, certain powers are preserved by the Governor in Council and, in these cases, CIMA provides recommendations for the Governor in Council to endorse or refuse.

The Law provides for licensing of insurance companies, managers, brokers and agents. Other notable provisions within the IL include the following:

minimum net worth margins of:

- US$120,000 must be maintained for general insurance business;

- US$240,000 for long-term business;

- US$360,000 for composite companies writing both general and long-term business.

In practice, the level of capital stipulated by CIMA on granting a licence may be higher according to the risks assessed in the company's business plan.

- changes in business plans plus any other changes from application require the prior approval of CIMA;
- all insurers must appoint an independent auditor and life insurers must appoint an actuary;
- captives must appoint a licensed insurance manager (unless they maintain a local office in a manner acceptable to CIMA);
- a licensee is required to file an audited statement of accounts to CIMA within six months of the year-end;

- separation of long-term (life) business and general business accounts.

The MAL deals with the overall mandate and functions of CIMA. It is also the legislation that ascribes statutory immunity to CIMA and its employees, subject to the usual "in good faith" test.

Section 42 of the MAL as amended by the MAICL allows information sharing with overseas regulators.

5.3.2 **Rules, regulations and guidance notes**

The relevant regulations are the Insurance (Forms) Regulations 1980 ("IFR"). They prescribe the application form and contents for obtaining a company licence or other types of licence, for example agents or managers.

Items specifically required include a business plan, financial and loss projections, latest annual report and audited accounts, curricula vitae and three references, including one from a bank. Applicants must also provide background information on their shareholders, directors and officers. A full vetting check is extended to non-executive directors and shareholders.

The Regulations also include annual reporting forms and procedures, including certificates of compliance, and actuarial reports where required.

There have been no guidance notes developed and issued to the insurance industry. However we are informed that regular communication with managers and licence holders takes place in which CIMA imparts guidance.

5.3.3 **Supervision - systems and procedures**

Companies wishing to carry on insurance business in or from within the islands must apply for and receive a licence from the Governor in Council. The Law provides a distinction between Class "A" or domestic insurance companies and Class "B" for non-Caymanian companies. In most respects the regulatory regime is the same for both classes of licence. There is a statutory requirement for Class "A" companies to hold funds locally to match their insurance liabilities under the direction of CIMA.

5.3.3.1 ***Off-site supervision***

Financial returns are analysed in depth, often resulting in requests for additional information. New companies are required to make a return after the first 6 months operations. Quarterly returns are called for in problem cases and also where CIMA has reason to monitor performance closely. The review of proposed business plan changes also provides an opportunity to assess performance.

The manager of a captive company has a statutory duty to inform the authority of any event which will affect the operations of the company.

5.3.3.2 ***On-site inspections***

To date CIMA have carried out 7 Class "A" and 2 Management Company inspections since its programme commenced in 1998. The scope of these inspections is wide and includes a review of the investment policy, underwriting and claims policies and procedures, reinsurance programmes, internal controls and proper record keeping.

Given the market profile of insurance companies in the Cayman Islands, CIMA has taken positive action by the introduction of on-site visits.

The MAICL amended section 30 of the MAL to require that CIMA monitor compliance with the Money Laundering Regulations 2000.

5.3.3.3 ***Financial statements***

The time scale before CIMA receive audited annual financial statements is currently six months after the year end.

5.3.3.4 ***Composite insurance business***

Jurisdictions world-wide have moved to require new applicants to set-up separate companies for life and general business. IAIS has recommended that the two types of insurance business should be written in separate companies as the nature of the risks is very different.

To mix the two within one entity can lead to the interests of either type of policyholder being unfairly subjugated to the interests of the others. There are no composite insurers in the Cayman Islands and we are informed that no such companies will be licensed, in accordance with IAIS Principles.

5.3.4 **Enforcement - systems and procedures**

CIMA's enforcement powers are the suspension or revocation of a licence, and ultimately a fine and imprisonment.

In addition, the Governor in Council has the power to require a licensee to take such steps to rectify the matter, pending a full enquiry into the licensee's affairs, where it is believed that the licensee is carrying on business in a manner likely to be detrimental to the public interest, or to the interest of its creditors or policy holders, or in contravention of the IL.

5.3.5 **Policy holder protection schemes**

No policy holder protection scheme exists for the Cayman Islands. CIMA inform us that any such scheme would only apply to the domestic insurance market which, in premium terms, only comprises 3% of the Cayman Islands insurance industry.

5.4 **Issues and recommendations**

5.4.1 **Introduction**

In view of the prominent position that the Cayman Islands plays within the captive sector of the offshore insurance market, it is necessary that the legislation in place is of an acceptable international standard.

5.4.2 **Enforcement powers**

The enforcement powers of the CIMA are restricted concerning the suspension or revocation of a licence.

We understand that proposed legislative changes will eliminate deficiencies in enforcement powers and we recommend that this legislation be implemented before the end of 2000. The revision should include the power for CIMA to issue licence limitations and conditions, fines and sanctions, the power to issue direction, cease and desist orders, and to take control of assets or the company itself and to appoint actuaries or auditors.

5.4.3 **Whistle blowing**

Presently insurance managers are required to advise the authority of any event which could affect the satisfactory operation and solvency of the company. We recommend that the statutory requirement should be extended to include auditors.

5.4.4 **Guidance**

Whilst regular communication takes place on matters of policy, prudential guidance notes should be issued following consultation with the industry. We recommend that guidelines are issued to cover the following areas: actuarial practice, confidence levels and discount rates, related party policy and liquidity.

We welcome your comments on this site.

Prepared 27 October 2000

6 Securities / investments

6.1 Introduction

There are established international standards in place concerning the regulation and supervision of those involved in the securities and investments sector. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of securities and investments conform to the standards outlined in the IOSCO paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

The relevant IOSCO Principles for this Section include:

- the responsibilities of the regulator should be clear and objectively stated (Principle 1);
- the regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers (Principle 3);
- the regulator should adopt clear and consistent regulatory processes (Principle 4);
- the regulator should have comprehensive inspection, investigation and surveillance powers (Principle 8);
- the regulator should have comprehensive enforcement powers (Principle 9); and
- the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme (Principle 10).

It is against the IOSCO standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

For the purpose of this report we have defined securities/investment business as covering the following range of activities:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

This section also covers mutual fund administrators. Legislation and regulation relating to collective investment schemes, mutual funds and, where appropriate, the stock exchange are covered in the following sections.

Mutual fund administrators do not come within the scope of IOSCO's principles and, therefore, there are no formal international standards in this area. Our evaluation of these administrators is therefore based upon the premise that compliance by administrators with IOSCO principles, as applicable, represents good practice and our recommendations should be read in this light.

6.2 Type and scale of activity

The activities of the administrators of mutual funds are regulated under the Mutual Funds Law ("MFL"). Under the MFL, in order for a regulated mutual fund to carry on business as an "administered fund", it is required to have a licensed mutual fund administrator provide its principal office. The regulation and supervision of funds under the MFL is covered in the next section.

There are 180 licensed administrators, all of whom have a registered office on the island, and approximately 80 of whom have a physical presence on the island.

The Cayman Islands' Government is currently drafting legislation to regulate other categories of investment business, including dealing, arranging deals, managing investments and investment advice as these activities currently fall outside the regulatory environment.

CIMA believe that the number of persons undertaking these unregulated activities is very small. Of those who are not already CIMA licence holders for other investment activities they undertake, two are covered under the CSX regime, and two are applying for CSX membership.

It is not possible to gauge exactly how many other securities brokers or investment advisers there are on the island. However, CIMA have advised us that that the Trade & Business Licensing Board will only licence new brokers if the applicant is obtaining membership of the CSX.

6.3 **Factual assessment**

6.3.1 **Legislation**

As stated above, the Cayman Islands does not have legislation covering securities and investment activities except in relation to mutual funds. Legislation is currently being drafted and adjusted for comment by the Cayman Islands' Government prior to being released to the private sector for comment ("the draft Act"). CIMA expect that the legislation will be considered by the Legislative Assembly in April 2001.

In respect of mutual fund administration, under the MFL there are three types of licensed mutual fund administrator:

- full - which allows the holder of the licence to carry on business as a mutual fund administrator in respect of an unlimited number of regulated funds;
- restricted - which allows the holder of the licence to carry on business as a mutual fund administrator in respect of a number of specified regulated funds up to a maximum of 10 funds; and
- exempted — whereby, on application, the Governor in Council may exempt a mutual fund administrator from obtaining a licence provided the applicant will not be administering more than one specified fund. A mutual fund administrator who has been exempted is regulated as if it were the holder of a restricted mutual fund administrator's licence. It should be noted that exemptions are no longer being granted.

6.3.1.1 ***Other legislation***

There is no legislation in place in the Cayman Islands which makes market manipulation and insider trading a criminal offence. We are informed such provisions are to be introduced under proposed securities legislation.

6.3.2 **Regulations/Guidance notes**

As the legislation for other categories of investment business is not yet in place, no regulations or guidance notes have been developed relating to investment/securities business undertaken by persons who are not members of CSX.

In respect of mutual fund administrators, section 36 (1) of the MFL and section 39 of the MAL makes provision for the Governor in Council to make such regulations as are required for the effective implementation of the two laws.

We have also been advised that, since the time of our on-site visit a Guidance Handbook has been produced. Furthermore, guidance is available on the CIMA web-site.

One regulation, the Mutual Funds Regulation (1998) Revision, has been issued pursuant to the MFL. This regulation deals exclusively with fees. We are informed CIMA has provided guidance to mutual fund administrators covering requirements for registration of administered funds, duties of principal offices, procedures for changes in principal offices by way of specified forms published in the Gazette, or by written and oral communications during prudential meetings.

6.3.3 **Supervision - systems and procedures**

6.3.3.1 ***Regulatory structure***

Mutual Fund Administrators' licences are approved by the Governor in Council on the recommendation of CIMA.

Mutual Fund Administrators are supervised on a day-to-day basis by CIMA. Within CIMA supervision is undertaken by the

department which is also responsible for company service providers and mutual funds themselves. As at 15 August 2000 there were eleven members of staff in the department.

The supervisory regime for mutual fund administrators is detailed below. In respect of other categories of investment business, as the legislation has not been finalised, the nature of the supervisory regime has not been concluded.

6.3.3.2 ***Licensing***

CIMA has issued licence application guidelines. These detail the information required from applicants. Under these guidelines a distinction is drawn between applicants incorporated in the Cayman Islands and those incorporated elsewhere. In the case of applicants incorporated outside the Islands fewer details are required. For instance audited accounts for one rather than two years are required and there are no requirements for Personal Questionnaires written evidence of professional knowledge and experience being required from the applicant's head office instead.

Nevertheless, CIMA advise us that they operate a practice of treating applications from administrators incorporated outside the Cayman Islands in the same way as those incorporated in the Cayman Islands.

Prior to recommending an applicant CIMA undertake due diligence checks. CIMA include in their due diligence process checks by the Financial Reporting Unit ("FRU") of the Royal Cayman Islands Police.

A number of licences, many of which, we are informed, were from companies already licensed under the BTCL or CML, were granted prior to this due diligence policy coming into effect. CIMA have advised us that the absence of such checks for these schemes will be rectified and checks of these licence holders will be undertaken.

6.3.3.3 ***Off-site supervision***

The auditors of the fund administrator are obligated, under Section 33 of the MFL, to notify CIMA in writing immediately when they become aware that the fund administrator:

- is or is likely to become unable to meet its obligations as they fall due;
- is carrying on business otherwise than in accordance with the MFL or any other law;
- is carrying on business in a manner that is or is likely to be prejudicial to investors or creditors of the mutual fund; or
- is carrying on or attempting to carry on business without keeping any or sufficient accounting records to allow its accounts to be properly audited.

In addition, audited financial statements for all fund administrators are submitted to CIMA and the statements are seen by an analyst. However at the time of our on-site review there were no formal documented procedures for review of returns or for any follow up queries resulting from this review. We have been advised that the procedure has now been improved and matters of a serious nature are logged on a "Status/Watch List Report" and brought to the attention of the Board. Minor matters are followed up by the Deputy Head on a brought forward system.

6.3.3.4 ***On-site supervision***

To date CIMA have carried out two on-site inspections of administrators who have a physical presence on the island.

CIMA have advised us that limited resources do not currently allow it to continue its on-site inspection programme. We have been advised by CIMA that they do, however, plan to recommence the visits by the end of September 2000.

6.3.4 **Enforcement - systems and procedures**

The details of the enforcement powers under the draft Act have yet to be finalised and were not available for review.

Enforcement powers relating to mutual fund administrators are detailed in the next section to this report.

6.3.5 **Investor compensation scheme**

There is no investor compensation scheme proposed under the draft Act.

6.3.6 **Anti-money laundering**

Licence holders are subject to the anti-money laundering legislation and Code of Practice, which covers, *inter alia*, "know your customer" requirements.

Although section 30 of the MAL, as amended by the MAICL, requires CIMA to monitor compliance with the Money Laundering Regulations 2000, the breach of those regulations by a licence holder is not, in itself, a ground for enforcement action. However, CIMA considers that a licensee carrying on business in breach of the regulations would be liable to disciplinary action as this would be carrying on business contrary to the public interest.

6.4 **Issues and recommendations**

6.4.1 **Introduction**

The Cayman Islands recognise that they are currently failing to meet international standards as laid down by IOSCO due to the lack of current legislation covering:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

This is a weakness which the Cayman Islands is currently seeking to address through new legislation, due to be introduced in April 2001.

We consider that the high priority that the Cayman Islands is currently giving to this legislation is appropriate and to be welcomed.

It should also be noted that, unlike a number of other jurisdictions, the Cayman Islands treats fund administration as a regulated activity. We consider this approach to represent good practice.

6.4.2 **Proposed legislation**

The latest draft of the proposed investment business law was not available for our review, however we understand that an earlier draft to which we have been granted access forms the basis of the final proposed piece of legislation.

Our conclusions based on the earlier draft bill indicate that it did not fully meet international standards set by IOSCO. We understand that the revised draft is proposing to remove these deficiencies with the aim of ensuring that the final legislation is in line with IOSCO Principles.

We agree with the Cayman Islands Government that it should ensure that sufficient subsidiary regulations are developed to ensure that the regulatory standards imposed upon licence holders under the new legislation are equivalent to those imposed upon CSX members.

We also support the Cayman Islands' stated commitment to ensure that it has an appropriate supervision infrastructure in place to enable effective off-site and on-site supervision. We are informed that these areas, together with regulatory co-operation, are to be addressed.

There is also a need for the Cayman Islands to introduce legislation criminalising insider trading and market manipulation which we understand is to be addressed.

This is important as not only might these offences be undertaken in or through the Cayman Islands but also the lack of appropriate laws means that they do not form part of offences covered by the Cayman Islands' anti-money laundering laws as they are therefore not predicate offences. (See the Anti-Money Laundering Section to this Report for details.) However, these offences are covered under the Mutual Legal Assistance Treaty.

6.4.3 **Applications to become a mutual fund administrator**

Where applications to become a licensed fund administrator were made prior to the due diligence checks undertaken by the FRU coming into force, those checks should now be made. We consider this a priority and a deadline for completion of 31 December 2000 should be set. CIMA have agreed to treat this as a priority issue.

Fund administrators, whether incorporated inside or outside the Cayman Islands, need to be subject to a similar vetting process. Therefore, for those incorporated outside the Cayman Islands, the information required at application should be expanded to include that required from those incorporated inside the jurisdiction, including personal questionnaires and references for shareholders, directors and officers.

We support CIMA's practice of treating applications from administrators incorporated outside the Cayman Islands in the same way as those incorporated inside the Cayman Islands. This practice does however need to be reflected in the formal requirements themselves.

6.4.4 **Supervision of mutual fund administrators**

We are concerned at the temporary cessation of on-site inspections of licensed administrators, particularly as this is due to resource constraints. We consider that on-site inspections are a vital regulatory tool and that their absence is a significant weakness.

Whilst we note that the programme is due to restart in September 2000 we consider that, given the number of licensed administrators, the programme must be significantly enhanced with a structured workplan. Whilst the frequency of visits will depend upon the nature of each individual licence holder, we would expect an average visit cycle of no more than three years. This will require additional resources.

We understand CIMA are currently pursuing a significant recruitment campaign as a first step in addressing these issues.

In addition to the on-site programme we consider that there should be an enhancement of the off-site review. In particular there should be formal documented procedures for review of returns or for any follow up queries resulting from this review. This will enable thoroughness and consistency in approach to be maintained. CIMA have confirmed agreement with this point and have advised us that since our on-site review they have developed an off-site review checklist which will be used in conjunction with a funds reference handbook for training purposes. We welcome this development.

We consider that any on-site supervisory regime developed for managers should pay particular attention to the methodology for supervising licence holders with no real presence in the Cayman Islands.

6.4.5 **Anti-money laundering**

We consider that a breach of any anti-money laundering laws, codes, guidance or regulations (see Section 15) should be formal express grounds for disciplinary action against a licence holder, including possible revocation of its licence. This will allow regulatory action to occur even where there is no criminal prosecution for breach of the anti money laundering legislation.

We welcome your comments on this site.

Prepared 27 October 2000

7 Mutual Funds

7.1 Introduction

There are established international standards in place concerning the regulation and supervision of collective investment schemes/mutual funds (referred to hereafter as mutual funds). The Terms of Reference for this review require us to look at whether the arrangements for the monitoring, supervision and regulation of mutual funds conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

Among the IOSCO Principles there are specific principles relating to mutual funds; these are:

- that the regulatory system should set standards for the licensing and the regulation of those who wish to market or operate mutual funds (Principle 17);
- the regulatory system should provide for rules governing the legal form and structure of mutual funds and the segregation and protection of client money and assets (Principle 18);
- regulation should require full, timely and accurate disclosure of financial results and other information which is necessary to evaluate the suitability of a collective investment fund for a particular investor and the value of the investor's interest in the scheme (Principle 19);
- regulations should ensure that there is a proper and disclosed basis for asset valuation and the pricing and redemption of units in a mutual fund (Principle 20).

Other principles, particularly regarding the responsibilities of the regulator, enforcement powers and co-operation also apply to the regulation and supervision of funds.

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

7.2 Type and scale of activity

The Cayman Islands is a significantly large offshore centre for the incorporation and administration of mutual funds and have legislation in place regarding their regulation and supervision.

Under the Mutual Funds law (1999 Revision), regulated mutual funds as defined by the Law, may become authorised and regulated in three different ways. The categories of funds as determined by the method of authorisation, are Administered, Registered and Licensed (a description of the different categories is given below).

There were 2,298 regulated mutual funds as at 7 March 2000 being 603 administered, 1,654 registered and 41 licensed schemes.

We are advised that registered schemes in particular are marketed to sophisticated or institutional investors, although we understand that this is the case for the other two categories as well.

CIMA are not required to keep up-to-date information on the levels of funds under management although they recognise the statistical usefulness of such data. The latest information available from CIMA was as at 31 December 1998 and indicated that there was over US$200 billion in funds under management. Since this time the industry has continued to grow.

7.3 Factual assessment

7.3.1 Legislation

Legislation of mutual funds in the Cayman Islands is via the MFL.

The following types of vehicle are permitted to be used as mutual funds:

- unit trusts;
- exempted trusts;
- exempted companies;
- foreign companies;
- limited duration companies;
- non-profit companies;
- ordinary non-resident companies;
- ordinary resident companies;
- exempted limited partnerships; and
- limited partnerships.

The following types of mutual funds are regulated under the MFL:

7.3.1.1 ***Administered schemes***

Administered schemes are registered under Section 3 (1) (b) of the MFL and may only carry on business in or from the islands if they comply with the requirements of that Section. Section 3 (1) (b) requires that the scheme's principal office is provided by a licensed mutual fund administrator.

7.3.1.2 ***Registered schemes***

Registered schemes may only carry on business in or from the Cayman Islands if they comply with Section 3 (3) of the MFL. This allows a fund to carry on business in or from the Cayman Islands if it is a mutual fund in which:

- the minimum aggregate equity interest purchasable by a prospective investor in the fund is CI$40,000 (US$50,000) (or its equivalent in any other currency); or
- the equity interests are listed on a stock exchange (including an 'over-the-counter' market) specified by CIMA by notice in the Gazette.

Unless an exemption from this requirement has been granted by CIMA, the prescribed details in respect of the mutual fund's current offering document must be filed with CIMA and the fund registered with CIMA in the prescribed manner.

7.3.1.3 ***Licensed schemes***

Licensed schemes may only carry on business in or from the Cayman Islands if they comply with Section 4 of the MFL. The criteria used by CIMA for licensing are as follows:

- each promoter must be of sound reputation;
- the administration of the mutual fund must be undertaken by persons who:

  have sufficient expertise to administer the mutual fund;

  are of sound reputation; and
- the business of the mutual fund and any offer of equity interests in it will be carried out in a proper way.

7.3.1.4 ***Unregulated schemes***

Unregulated schemes are mutual funds in which equity interests are held by not more than fifteen investors, the majority of whom are capable of appointing or removing the operator of the fund. In line with common practice they are not required to

comply with Section 3(1) and are therefore unregulated. This approach is similar to that taken in a number of other jurisdictions.

7.3.2 **Regulations**

Section 36 (1) of the MFL and Section 39 of the MAL makes provision for the Governor in Council to make such regulations as are required for the effective implementation of the two laws.

One regulation, the Mutual Funds Regulation (1998) Revision, has been issued pursuant to the MFL. This regulation deals exclusively with fees.

7.3.3 **Guidance notes**

We are advised by CIMA that, in general, guidance is provided on a one to one basis rather than through formal guidance notes though we are informed some guidance on the application process has been provided in notes to gazetted forms. We have also been advised that, since the time of our on-site visit a Guidance Handbook has been produced. Furthermore, guidance is available on the CIMA web-site.

However, one guidance note has been issued by CIMA in respect of the mutual funds industry. This related to the revocation and surrender of Mutual Fund Licences and Certificates of Registration, on which the MFL is silent.

7.3.4 **Supervision - systems and procedures**

7.3.4.1 ***Regulatory structure***

Licensing, registration and day-to-day supervision of the mutual funds industry is undertaken by CIMA. Within CIMA, supervision is undertaken by the department which is also responsible for company service providers and mutual fund administrators. There were eleven members of staff in the department as at 15 August 2000.

CIMA is a member of the Offshore Group of Collective Investment Scheme Supervisors.

Supervision is carried out in three ways. First, through the licensing/registration of Funds and Administrators, secondly through review of the annual financial statements and thirdly through on-site inspections.

7.3.4.2 ***Licensing/registration***

The licensing and registration of funds must be authorised by CIMA in relation to each of the types of fund outlined above. CIMA receives a copy of the fund's offering documents as well as an application form for each fund.

In the case of administered and registered schemes, the due diligence is carried out by the administrators or promoters on the island and reliance is placed by CIMA on the due diligence they undertake. However, CIMA has ultimate responsibility and can reject or seek further information in relation to an application. Licensed mutual fund administrators are obliged under Section 15 and 16 of the MFL to ensure that the business of the fund, *inter alia*, is carried out in a manner that is not prejudicial to its investors and creditors.

Licensed schemes apply directly to CIMA and the policy is that CIMA include in their due diligence process checks by the FRU of the Royal Cayman Islands Police.

Of the 41 licensed schemes, 33 were established prior to this due diligence policy coming into effect. CIMA have advised us that the absence of such checks for these schemes will be rectified and we are informed checks of these schemes have commenced.

7.3.4.3 ***Off-site supervision***

Ongoing monitoring of funds is primarily a reactive process. CIMA will act when they become aware of any issues of concern. In doing so CIMA place reliance on the Licensed Mutual Fund Administrator and the auditors of the fund who are obligated, under Sections 16 and 33 (1) of the MFL, respectively, to notify CIMA in writing immediately they become aware that the fund (or administrator) or promoter or operator of a fund:

- is or is likely to become unable to meet its obligations as they fall due;
- is carrying on business otherwise than in accordance with the MFL or any other law;

- is carrying on business in a manner that is, or is likely to be, prejudicial to investors or creditors of the mutual fund; or
- is carrying on or attempting to carry on business without keeping any or sufficient accounting records to allow its accounts to be properly audited.

Whilst audited financial statements for all funds are submitted to CIMA and are seen by an analyst at the time of our on-site review there were no formal documented procedures for review of these statements or for any follow up queries resulting from this review.

We have been advised by CIMA that they have now introduced a system under which audited financial statements are submitted to them and the statements are reviewed by the Deputy Head of the Division who monitors issues requiring attention.

In addition matters of a serious nature are logged on a "Status/Watch List Report" and brought to the attention of the Board. Minor matters are followed-up by the Deputy Head on a brought forward system.

7.3.4.4 ***On-site supervision***

To date CIMA have carried out two on-site inspections of administrators who have a physical presence on the island and a review of funds is covered in the review of the fund administrator.

CIMA have advised us that limited resources do not currently allow it to continue its on-site inspection programme. We have been advised by CIMA that they do, however, plan to recommence the visits by the end of September 2000 and, we are informed, a significant recruitment drive has begun as a first step toward this.

The MAICL amended section 30 of the MAL to require that CIMA monitor compliance with the Money Laundering Regulations 2000.

7.3.5 **Enforcement - systems and procedures**

CIMA's powers to enforce legislative and regulatory requirements with regard to funds are contained in Parts IV and V of the MFL. These powers allow CIMA in the case of mutual funds and the Governor in Council in the case of mutual fund administrators to:

- instruct special audits to take place of funds or administrators (sections 22 and 25);
- collect information from funds or administrators (licensed or unlicensed) if they have reasonable grounds for believing business is being carried on in contravention of the MFL (sections 23 and 26);
- apply to the Grand Court for such order as it thinks fit to preserve the assets of the investors in the funds (section 24);
- apply to the Grand Court for such order as it thinks fit if unlicensed business is being carried out (sections 24 and 27);
- revoke a fund's licence (section 29);
- impose conditions or further conditions (section 29);
- require a mutual fund to re-organise its affairs in a manner specified by CIMA (section 29);
- require the substitution of any promoter or operator (section 29);
- appoint a person to advise the fund on the proper conduct of its affairs (section 29); and
- appoint a person to assume control of the affairs of a mutual fund.

Part V Sections 30(5), (6) and (7) of the MAL also contain enforcement powers allowing access to the books and records of any mutual fund at any time.

Further, the MAL gives CIMA the power to request such information or explanation that it reasonably requires. A breach of this law is a criminal offence punishable by a fine.

Whilst there is no specific power under the MFL to wind up a fund "in the public interest" CIMA has equivalent power to wind up the affairs of funds pursuant to Section 29(11) of the MFL. Similar powers exist for the Governor in Council in relation to mutual fund administrators.

Enforcement powers have been exercised three times over the past three years on the grounds that a scheme may have been unable to meet its obligations or it may have been carrying on business in a manner that is prejudicial to its investors or creditors.

7.3.6 **Investor compensation schemes**

There are no investor compensation schemes for mutual funds in the Cayman Islands.

7.4 **Issues and recommendations**

7.4.1 **Introduction**

The existence of a regulatory and supervisory structure for mutual funds in the Cayman Islands is a positive feature of the jurisdiction's regulatory environment. A number of features of the legislation, including the wide ranging enforcement powers, meet IOSCO standards. However, there remains a lack of regulations relating to the operation of the funds including the segregation of client monies. In addition the lack of a current on-site inspection programme and the limited nature of the off-site review must be seen as a priority for action.

Nevertheless, given the size of the mutual fund industry in the Cayman Islands it is vital that the regulatory and supervisory regime is fully robust and we consider that a number of matters need to be addressed in order to ensure compliance with international standards.

The importance of a robust regulatory regime is increased by the use of licensed administrators to undertake the initial due diligence vetting of the administered schemes regime. Whilst these licence holders are under a statutory duty in undertaking their role the need for CIMA to verify that they are fulfilling this duty remains.

CIMA have represented to us their agreement with our position and, we are advised, have already commenced work to address the points raised.

7.4.2 **Segregation of public and non-public funds**

The great majority of Cayman Islands mutual funds are non-public, being aimed at institutional and sophisticated investors and the legislation by design therefore does not distinguish between public and private funds. Whilst the Cayman Islands' regulation of non-public mutual funds is not to IOSCO standards (which do not distinguish between public and non-public funds) the approach taken by the Cayman Islands is, in part, similar to that taken to non-public funds by a number of other jurisdictions. Where a Cayman Islands mutual fund is marketed on a retail basis it will be obliged by the relevant jurisdiction to comply with its laws (if any).

In order to meet international standards, the current legislative framework in the Cayman Islands would either be required to bring all fund types in line with IOSCO Principles, or to distinguish clearly between public and non-public funds.

In general, we consider that, as a matter of good practice non-public funds should be subject to initial vetting and that enforcement and supervisory powers should exist. However, in line with general international practice there need be no specific requirements along the lines envisaged by the IOSCO Principles because of the nature of the investors involved.

Therefore we are of the opinion that the Cayman Islands should consider whether they wish to amend the MFL to differentiate between public and non-public funds. If such a distinction is made the recommendations below should be seen as relating to public funds particularly in relation to supervision and regulations.

7.4.3 **Ongoing supervision**

7.4.3.1 ***On-site***

The most immediate area for attention is in relation to on-site supervision. There is an urgent need for full and effective on-site inspections to verify compliance. The current lack of such visits due to resource constraints is a matter of concern.

This is particularly important, in the case of the Cayman Islands, because of the initial vetting responsibilities of licensed

fund administrators in relation to administered schemes.

The lack of current on-site programme means the Cayman Islands cannot comply with IOSCO Principle 10. Once restarted the on-site inspections should also be extended to cover the Cayman Islands funds administered by administrators based off the Islands.

We understand CIMA are currently pursuing a significant recruitment campaign as a first step in addressing these issues.

7.4.3.2 ***Off-site***

We agree with CIMA that there needs to be an improvement in its off-site monitoring programme and that this must be a priority. Such a programme is also necessary in order for IOSCO Principle 10 to be fully adhered to.

We consider that off-site monitoring should be designed to enable the Registrar to assess the activities of a fund and to identify potential risk areas which may be evidence of a regulatory breach or increase the likelihood of such a breach in the future. This should be achieved through a formal documented review programme.

Such a programme should include the receipt and monitoring of the annual audited accounts of funds and details of fund size and composition on a quarterly basis.

The details of fund composition should be compared against the funds' constitutional documents to ensure that the composition is in accordance with the funds' objectives and asset holding policies.

CIMA have advised that they are working on revised off-site review procedures in response to these points.

7.4.4 **Applications**

We consider CIMA are in a better position than the licensed mutual fund administrator to undertake the vetting of the suitability of an applicant in accordance with IOSCO Principle 17. This is because CIMA has access both to the FRU, and, where appropriate, regulators in other jurisdictions, so enabling a more detailed vetting to be undertaken.

We therefore consider it preferable that CIMA is directly responsible for vetting applications for all types of schemes.

If, however, the current approach is to be maintained, it is vital that the initial vetting of whether an applicant is "fit and proper" is properly monitored by CIMA, including inspections of the checks made. Whilst there are general obligations contained in Sections 15 and 16 of the MFL we agree with CIMA that these should be supplemented by additional requirements which clarify the duties of the licensed mutual fund administrator when vetting applications and when carrying out its duties.

The duties of the licensed fund administrator when undertaking due diligence should include checking:

- honesty and integrity;
- competence;
- financial capacity; and
- internal management procedures.

We also support CIMA's view that these requirements should provide for penalties against licensed mutual fund administrators who contravene them.

We note that CIMA is responsible for the final vetting of applications by administered and registered funds and can reject or seek further information where it considers it to be appropriate to do so. As part of this process we consider that CIMA should undertake its own vetting checks on a selective basis to verify the effectiveness of licensed mutual fund administrators' vetting procedures. We have been advised by CIMA that they propose to institute such a procedure as part of their on-site inspection review. We welcome this development.

Where applications for licensed schemes were made prior to the due diligence arrangements arising from the FRU coming into force, have been advised by CIMA that they accept this and have already commenced this process.

7.4.5 **Enforcement powers**

The MFL contains a range of enforcement powers and therefore is broadly in line with IOSCO Principle 9.

However, to fully meet this Principle and to enable CIMA to be able to take the full range of actions necessary to meet possible eventualities, the additional powers should include the ability to fine for breaches of the MFL. The powers should be extended to cover breaches of the Anti-Money Laundering Code of Practice and any regulations made under the MFL.

7.4.6 **Regulations**

CIMA recognise that there is a need to introduce regulations in relation to public mutual funds. This is necessary both to ensure that such funds are operating in line with IOSCO Principles relating to mutual funds and that investors are protected from potential abuse. In order to meet these international standards these regulations should include the segregation and protection of client assets. The regulations should also expand on the information requirements in section 3(6) of the MFL. This section provides general information requirements for offer documents consistent with the common law test. However we consider more specific obligations should be introduced concerning the content of the prospectus and other constitutional documents for public funds. This is to enable informed decision making by prospective investors.

The expansion of section 3(6) of the MFL should be such as to require that a prospectus include information to enable a prospective investor to assess suitability as well as provide details of the basis of valuation and pricing and redemption of units and the fee structure.

The inclusion of such regulations will enable the regulation of mutual funds to comply with IOSCO Principles.

In order that CIMA can verify compliance with the legislative and regulatory requirements, regulations should also include requirements regarding the retention by the funds of such records as are necessary for effective supervision to be undertaken (e.g. dealing and accounting records). As on-site inspections and investigations are, inevitably, partially dependent on a review of records, it is important that there should be a requirement that the necessary records are maintained. We note that client information record retention is now required under the Money Laundering Regulations 2000.

The regulations should also require compliance with any anti-money laundering regulatory code. Failure to comply should be grounds for disciplinary action including the possible revocation of a licence.

7.4.7 **Unregulated schemes**

Whilst the exemption for schemes with fifteen or fewer participants is an approach similar to that taken in other jurisdictions, there is a risk that such schemes may be susceptible to money laundering and other abuse. Appropriate safeguards are therefore necessary to prevent such potential abuse. Whilst unregulated schemes are covered under the PCCL and the Code of Practice, there is a need to ensure that the anti-money laundering regulations clearly apply to them.

Prepared 27 October 2000

8 Stock exchange

8.1 Introduction

There are established international standards in place concerning the regulation and supervision of stock exchanges. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of these exchanges conform to the standards outlined in the IOSCO paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

The IOSCO principles which relate to the oversight and regulation of stock exchanges are as follows:

- Self-regulation (principles 6 and 7);
- Issuers (principles 14 to 16);
- Market Intermediaries (principles 21 to 24); and
- The Secondary Market (principles 25 to 30).

The principles for self-regulation address two supervisory relationships. The first of these covers the supervisory activities of the exchange as an SRO and is addressed in this section of the report. The second principle relates to the oversight by the regulator of its SRO and is covered in the section on the regulatory authority.

8.2 Type and scale of activity

The CSX was established by legislation in 1996. Under the law, the CSX has the exclusive right to operate securities markets in the Cayman Islands.

The CSX is wholly owned by the Cayman Islands Government and is managed by a council appointed by the Stock Exchange Authority ("the Authority").

In 1999, the CSX was granted approved organisation status by the London Stock Exchange. The CSX is an FIBV corresponding emerging market.

The CSX currently has six broker members with a total of nineteen registered persons and eleven listing agents. The following markets are operated and contain listed instruments. The listing figures are as at 28 August 2000:

- domestic issuers — equity (1);
- secondary listings (international companies) (2);
- specialist debt securities (67);
- mutual funds (280);
- derivative warrants (31).

Total market capitalisation was US$32.7 billion. To date, no trading has taken place on the CSX.

The CSX has rules in place covering depository receipts but none are listed. There is one domestic issuer listed on the CSX. No trading has taken place in any of the mutual funds as investors can deal directly with the fund manager. The specialist debt securities and derivative warrants are mostly bought and held to maturity. Those that do trade are dealt over the counter.

8.3 Factual assessment

8.3.1 **Legislation**

The CSX is subject to the Stock Exchange Company Law 1996 (the "SECL"). This established the CSX as a "for profit" private limited company. The law established an autonomous body, the Authority, as a dedicated regulator for the CSX. The Authority is separate from CIMA and the Governor in Council. Section 3(1) of the law states that the Authority is responsible for the policy, regulation and supervision of the CSX. By virtue of Sections 11 and 12 of the law the Authority approves all rules of CSX.

The Authority is effectively a committee of five members comprising the Financial Secretary, the head of CIMA, the Attorney-General, the Deputy Financial Secretary and the Deputy Director of the Economics and Statistics Office. The Authority has no full-time staff.

8.3.2 **Rules and regulations**

The CSX is subject to regulatory oversight by the Authority.

The CSX membership rules set out the initial requirements and ongoing obligations for those entities seeking trading membership privileges and the listing rules set out the requirements and ongoing obligations of those entities seeking listing agent privileges.

All listings for domestic issuers and mutual funds must appoint a listing agent. A listing agent is not a member of the CSX but is recognised by the CSX as qualified to act as a listing agent.

Listing rules covering qualifications for listing, the application procedures and requirements and an issuer's continuing obligations, are in place for all markets referred to in section 8.2.

There is a CSX code on take-overs and mergers and rules governing substantial acquisitions of shares. The code applies to all companies listed on the CSX other than open-ended mutual funds.

8.3.3 **Guidance**

The CSX has issued no guidance or practice notes for its users. There is, however, a user guide to its Bloomberg online trading system.

8.3.4 **Supervision - systems and procedures**

The current supervision of the CSX is undertaken by "as necessary" meetings with the Authority, supported by a monthly report and annual operational report and accounts. The Authority also approves any rules the Exchange wishes to make

Investment business is not regulated and the CSX operates as a SRO with regard to its members. The CSX carries out vetting procedures for its new members. Enquiries and due diligence activities are co-ordinated with CIMA when members are also regulated by it. Application for membership will only be considered from entities, direct branches, wholly owned or controlled subsidiaries of those regulated by a recognised regulatory body or stock exchange or who are in possession of a banking, trust or non-restricted mutual funds administrators licence granted by CIMA or an equivalent overseas regulator.

The CSX monitors minimum capital requirements by requiring monthly financial reporting from members.

It is the intention that the CSX carries out inspection visits every one to two years depending on the member's profile. Liaison takes place with CIMA to co-ordinate visits and to avoid duplication of effort. Inspections have only recently commenced.

The CSX does not monitor trading activity as no trading currently takes place on the Exchange. Monitoring activity is concentrated on net asset values and an alert system is in place.

The primary surveillance functions of the CSX are those carried out by the listing department with respect to the continuing obligations of listed issuers and by the market development department with respect to the conduct of business of broker members.

The listing rules require varying degrees of disclosure depending on the market and impose continuing obligations on issuers. The rules give CSX the power to make enquiries of listed issuers. Listing application files demonstrate that vetting procedures are carried out and a formal checklist is used in the process.

Listing agents must either be licensed or practice as an attorney or accountant, or a firm of attorneys or accountants, in the Cayman Islands. The CSX carries out vetting procedures for new listing agents. Although there was historically no checklist on the files to demonstrate the carrying out of these procedures we have been advised one is currently being developed. A register of listing agents is maintained by the CSX.

8.3.5 **Enforcement - systems and procedures**

The CSX has investigation powers and can require members to produce all books and records and can require the attendance of any agent or employee of a broker member to attend before it to answer questions. The CSX also has access to client information.

The CSX has the power to instigate disciplinary action against a member for a breach of the membership rules. The CSX can fine, order restitution to any person, privately or publicly censure, suspend the right to use any system of the CSX, suspend from dealing, or expel a member.

The CSX can sanction listing agents. It can privately or publicly censure or remove a listing agent from the register of listing agents maintained by the CSX.

The CSX has the power to sanction issuers for a breach of the listing rules. It can also privately or publicly censure the issuer and/or its directors, suspend the issuer's listing or make a public statement that the continued retention or appointment of certain directors of the issuer is prejudicial to the interests of the investors.

Appeals procedures are in place with regard to disciplinary action against members, registered persons, listing agents and listed issuers.

8.3.6 **Investor protection schemes**

There are no investor protection schemes.

8.4 **Issues and recommendations**

8.4.1 **Introduction**

While a trading platform exists, to date the CSX has operated a listing function, as a mechanism to provide marketability to mutual funds, derivative warrants and specialist debt. These markets are growing at a steady and manageable rate.

The CSX has in place the necessary infrastructure and processes to allow trading to take place via a simple order book system which provides a real time feed into Bloomberg.

The CSX has in place rules for a manual settlement process should such a process be required in the future. All members are required by the rules to settle every transaction effected by it in whatever jurisdiction.

In light of the above, an assessment against IOSCO principles, with the exception of the principles for issuers and the supervision of the SRO by the regulator, becomes a largely theoretical exercise. Consequently, the sections which follow reflect our views on the current position of the exchange rather than a series of recommendations.

8.4.2 **Membership**

Member firms are regulated by means of off-site information, consultation and on-site visits. The programme of on-site inspections commenced during December 1999 and to date two inspections have been completed. Inspection procedures are set out and require completion checks. In our view, membership regulation is of international standards.

8.4.3 **Listings**

Regulation of listing applications and continuing obligations is undertaken by four listing staff and the listing committee. Although full checklists for use in vetting listing applications were being developed at the time of our visit and were not used historically, we have been advised that procedures are now used. In our view listing regulation meets international standards.

8.4.4 **Money laundering**

All staff have been familiarised with the money laundering code and training programmes are in place.

8.4.5 **Co-operation**

The CSX currently has no memoranda of understanding with other regulatory bodies. Discussions are currently in process with an overseas exchange. There is evidence of co-operation with overseas regulators. There is ongoing co-operation with domestic regulators including the criminal authorities.

We welcome your comments on this site.

Prepared 27 October 2000

9 Companies

9.1 Introduction

As recognised by the TOR, there are no specific international standards concerning the regulation and supervision of companies. However, there are a number of international standards concerning the operation and management of companies. These include the OECD "Principles of Corporate Governance", the G7 "Report on Transparency and Accountability" and the IMF "Guide to Progress in Strengthening the Global Financial Architecture". There is also the work of the International Accounting Standards Committee. Whilst other international standards exist, these primarily relate to particular financial services activities such as banking, securities and insurance and many of their requirements are not directly applicable to ordinary trading and holding companies.

The OECD Principles cover:

- the rights of shareholders;
- the equitable treatment of shareholders;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board of directors.

The Guidance Notes cover the following additional issues with regard to companies:

- the ability of law enforcement and regulatory authorities to identify, quickly and efficiently, the shareholders and directors of a company and the beneficial owners of a company's shares;
- the ready availability of financial information relevant to the activities of companies to law enforcement and regulatory authorities;
- requirements concerning accounting disclosure and auditing practice, particularly where there are obligations to third parties;
- the circumstances in which accounts should be produced and when accounts should be made public;
- the investigation enforcement powers available to the OT; and
- standards of corporate governance.

The TOR and the Guidance Notes cover companies and company service providers together. This is necessary because a proper consideration of the issues involves both. However, we consider that it is useful to consider them separately which we have done in this Report.

We consider that the regulation of company service providers is the most practical and effective way of deterring the abuse of company structures and of ensuring that relevant information is available to law enforcement and regulatory authorities. This approach is in accordance with the views expressed in the recent UK Home Office "Review of Financial Regulation in the Crown Dependencies" (Section 13.4.1). Nevertheless, there are areas where the requirements imposed upon companies themselves need to be enhanced.

In considering these enhancements, we have not undertaken a review of company or insolvency law as a whole. The TOR do not require us to do this. Instead we have assessed the legislation and regulation of companies in the Cayman Islands against the international standards referred to above and the criteria in the Guidance Notes as summarised above.

9.2 Type and scale of activity

All Cayman Island companies are incorporated under the Companies Law (2000 Revision) ("the CL"). A company incorporated under the CL may be an ordinary company or it may be registered under Section 183 as an exempted company.

Companies incorporated under the CL fall into one of the following categories:

- resident company (ordinary company);
- non-resident company (ordinary company);
- exempted company;
- Limited duration company ("LDC") (exempted company); or
- Segregated portfolio company ("SPC") (exempted Class B insurance company).

Resident companies are used for domestic purposes.

Exempted and non-resident companies, LDCs and SPCs, are used as offshore vehicles. The Cayman Islands do not have International Business Companies.

The Cayman Islands is a significant centre for the incorporation of companies as the table below shows. Whilst no specific information is required to be maintained on the main geographical markets for Cayman Island companies, nor on the uses to which such companies are put, we understand that the uses of these companies are similar to that of corporate vehicles incorporated in other offshore jurisdictions, for example for investment, asset holding, capital market structures and mutual funds.

The table below shows the numbers of companies incorporated in each of the last three years, by category and the total incorporated to 31 December 1999.

Type of company	**1997**	**1998**	**1999**	**Total at 31/12/99**
Resident companies	369	383	415	3614
Non-resident companies	1,326	1,258	1,523	11,342
Exempted companies	6,369	6,636	7,238	34,500
LDCs	160	143	98	675
SPCs	-	4	9	13

9.3 **Factual Assessment**

9.3.1 **Legislation**

9.3.1.1 ***Introduction***

There is one piece of corporate legislation in the Cayman Islands, the CL which covers the incorporation, operation, removal and redomiciliation of companies in the Cayman Islands. The CL is administered by the Registrar of Companies appointed under the CL ("the Registrar").

English common law principles apply to matters such as directors' duties and the equitable treatment of shareholders.

9.3.1.2 ***Companies Law***

A Cayman Islands company may be:

- a company limited by shares;
- a company limited by guarantee; or
- an unlimited company.

Every Cayman Islands company must have a registered office in the Cayman Islands. Notice of the situation of the registered office must be filed with the Registrar and published by Public Notice.

A member of the public is entitled to be informed of the registered office of a Cayman Islands company by the Registrar.

The CL does not contain the concept of a registered agent.

The provision of registered office services is not a regulated activity in the Cayman Islands. However, the Registrar has instituted a policy that only the following persons may submit documentation for the incorporation of, and provide the registered office for, non-resident and exempted companies:

- law firms;
- accountancy firms;
- company managers; and
- mutual fund administrators.

This policy does not have statutory force.

The CL does not require any type of company to prepare or file audited accounts.

Resident companies

An ordinary company may be designated as non-resident under the Local Companies (Control) Law (1995 Revision) ("LCCL"). Ordinary companies which are not so designated are known as resident companies.

Subject to any restrictions in its memorandum of association, a resident company may carry out any lawful object. A resident company may, therefore, carry on business or hold property both within and outside the Cayman Islands. At least 60% of the shares in a resident company must be owned by Caymanians.

9.3.1.3 ***Non-resident companies***

By virtue of the LCCL, a non-resident company may not carry on business within the Cayman Islands. This exclusion is subject to certain exceptions provided for in the LCCL which, essentially, allow it to have an administrative office in the Cayman Islands and to conduct certain business in the Cayman Islands in furtherance of its business outside the Cayman Islands.

The principal difference between a resident and a non-resident company is its status under the LCCL. A non-resident company can be re-registered under the CL as an exempted company, a resident company may not be. Otherwise, the status of a non-resident company under the CL is identical to that of a resident company. Therefore, both resident and non-resident companies are considered together in this section as "ordinary companies".

Exempted companies

An exempted company may be registered as an LDC under section 198 of the CL. An exempted company which only undertakes business requiring it to hold a Class B Insurer's Licence may register under section 229 as an SPC.

The main differences between an exempted company and an ordinary company are as follows:

- an exempted company may not trade in the Cayman Islands with any person, firm or corporation except in furtherance of its business carried on outside the Cayman Islands (section 193);
- an exempted company may issue bearer shares (section 185) and shares with no par value (section 8);
- an exempted company is not required to file an annual list of members and return of capital, but must file an annual declaration that, *inter alia*, it has not carried on business within the Cayman Islands (sections 41 and 187);
- the board of directors of an exempted company must hold at least one meeting in the Cayman Islands each year (section 194);
- an exempted company may not make any invitation to the public in the Cayman Islands to subscribe for any of its securities unless it is listed on the Cayman Islands Stock Exchange (section 195); and

- an exempted company may keep its register of members outside the Cayman Islands and its members do not have the right to inspect it (section 44).

LDCs

An LDC is an exempted company and accordingly the previous paragraph applies also to LDCs.

The main features of an LDC are:

- its duration must be limited to 30 years (section 198);
- its name must end with "Limited Duration Company" or "LDC" (section 198);
- its articles may contain certain provisions relating to controls over the transfer of shares and management of the LDC by its members (section 199);
- a voluntary winding up is taken to have commenced on the expiration of its term or on certain other specified events (section 200);
- it will cease to be an LDC on certain specified events (section 201).

SPCs

An SPC may create one or more segregated portfolios in order to segregate the assets and liabilities held within or on behalf of a portfolio from assets and liabilities of the company held within or on behalf of any other segregated portfolio.

Only a Class B insurance company may be an SPC.

Foreign companies

A body corporate incorporated outside the Cayman Islands which establishes a place of business or carries on business within the Cayman Islands, referred to as a "foreign company", must, within one month of doing so, file with the Registrar for registration under section 202.

9.3.2 **Regulations, rules and guidance notes**

The only regulations issued under the CL are the Companies (Forms) Rules, which prescribe the form of a notice to dissenting shareholders.

No formal guidance has been issued in respect of the Cayman Islands companies.

9.3.3 **Supervision - systems and procedures**

9.3.3.1 ***Regulatory structure***

The Companies Registry has 23 staff including the Registrar. The Registry has the benefit of a computer system which records basic company information in a database. There is no electronic (imaged) or microfiche storage of documents filed.

There is a significant filing backlog which appears to be due to under-staffing. However, we have been advised that the Registry is currently reviewing a project proposal for electronic document storage which it intends to implement shortly.

The Registrar (who reports to the Financial Secretary) is responsible for maintaining the Register of Cayman Islands companies and for registering documents filed. Although some basic checks may be undertaken, this is essentially a recording function.

As the Registrar's role is not a regulatory one, there is little supervision of companies by the Registry in the Cayman Islands. The Registrar's primary supervisory responsibility is ensuring compliance with filing requirements.

9.3.4 **Enforcement - systems and procedures**

9.3.4.1 ***Introduction***

The enforcement powers available in respect of companies are inspection, winding up and striking off powers.

9.3.4.2 ***Inspection***

The Court may appoint inspectors to examine the affairs of the company on the application of a specified proportion of members.

9.3.4.3 ***Striking off***

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, or where an exempted company does not file its annual return or pay its annual fee, he may strike the company off the register of companies.

9.3.4.4 ***Winding up***

The CL contains powers for members and creditors to apply for winding up.

However, there is no power under the CL for the Registrar to petition the court for the winding up of a company.

9.3.5 **Public availability of information**

The information concerning a Cayman Islands company which is held by the Registrar includes:

- the capital of the company;
- the names and addresses of the subscribers;
- the dates of execution and filing of the memorandum of association;
- the address of the registered office; and
- the directors of the company.

The following information and/or documentation held by the Registrar is available for public inspection:

- confirmation of the existence of a company, its type and status;
- the registration date of a company; and
- the address of the registered office of the company.

The register of members of a Cayman Islands company, except that of an exempted company, is open to public inspection at the registered office of the company.

9.3.6 **Non-public information**

A Cayman Islands company must maintain the following registers, books and records, all of which must be kept at the registered office of the company (unless otherwise indicated):

- a register of members containing the names and addresses of members and including a statement of shares held by each member and the date upon which each member became and ceased to be a member (except an exempted company which may keep its register of members at any place within or outside the Cayman Islands);
- a register of mortgages and charges (limited company only);
- a register of directors;
- proper books of accounts complying with section 59 (no requirement to keep at registered office); and
- minutes of all resolutions and proceedings of members and directors or managers (no requirement to keep at registered office).

Where bearer shares are issued, the entry in the register of members must record the date of issue of the bearer shares.

None of the above records, except the register of members, are available for inspection by members of the public. We note that the members of an exempted company do not have the right to inspect the register of members. However we have been

advised by the Cayman Islands' government that it is common practice for such a right to be included in the company's articles of association.

The register of mortgages and charges is open to inspection by any creditor or member of the company.

There is no requirement for a written record of the location of the other books and records of the company to be maintained.

9.3.7 **Directors**

The CL does not specifically provide for the appointment of the directors of a Cayman Islands company, the minimum number of directors or the powers and duties of the directors. Although the model articles in Table A make provision for the appointment of directors and their powers and duties, a Cayman Islands company may exclude or modify Table A.

Corporate directors are permitted.

There are no provisions enabling an individual to be disqualified from being a director of a company on the grounds that he is not fit to be a director of a company.

9.3.8 **Beneficial ownership**

There is no requirement under the CL for the beneficial owners of shares in a Cayman Islands company to be notified to the company or to the Registrar.

9.3.9 **Bearer shares**

Subject to any limitations in its memorandum or articles of association, an exempted company can issue bearer shares.

There is no requirement for exempted companies to file details of shareholders and it is therefore impossible to ascertain the proportion of exempted companies which have issued bearer shares. Nevertheless, it is clear from our discussions with representatives of the financial services industry in the Cayman Islands that bearer shares are issued. However, we are advised that this happens only rarely.

A company empowered to issue bearer shares may not hold land in the Cayman Islands.

9.3.10 **Insolvency**

Part V of the CL provides for the winding up of companies.

9.4 **Issues and recommendations**

9.4.1 **Introduction**

Given the limitations imposed upon us by the TOR, as set out in the Guidance Notes we have not undertaken a full review of any legislation relating to companies. In the circumstances, our specific recommendations should not be considered to be exhaustive. However, we have reviewed those aspects of the legislation which bear directly on our TOR and taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

While we understand that English common law is of application, based on our overview, we consider that the CL lacks many of the features found in a modern piece of companies legislation and is in need of review. We recommend that the review should include insolvency provisions, control over the issue of prospectuses, the protection of the interests of minority shareholders, enforcement powers, the disqualification of directors and auditing of public companies.

9.4.2 **Companies**

9.4.2.1 ***Publicly traded companies***

The preamble to the OECD Principles ("the Principles") states that "The Principles focus on publicly traded companies". Similarly, we consider that the G22 Report and the IMF Guide are primarily focused on public and publicly traded companies.

We consider that, where Cayman Islands companies can be publicly traded, they should, under international standards, be subject to the OECD Principles, together with the G7 and IMF standards.

There are two views which can be taken of this. The first is that a stock exchange should not list a company from a jurisdiction whose companies legislation fails to meet the Principles. The second is that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework (taking the legislation and case law together) fully meets the Principles and the G7 and IMF standards.

In our opinion, although the first view is undoubtedly correct, a jurisdiction should not rely on exchanges in other jurisdictions to "police" the Principles on its behalf. In our view, good practice dictates that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework complies with international standards. We consider that the same standards should apply where the shares of a company can be offered for sale to the public, even if those shares are not publicly traded.

Furthermore, the recommendations of the G22 Working Group on transparency and accountability include a recommendation that national standards for disclosure should reflect five basic elements: timeliness, completeness, consistency, risk management and audit and control processes.

There is no distinction in the CL between public and private companies. Subject to section 195 of the CL, any company can issue shares to the public and its shares may be publicly traded. This does not meet international standards. We do note that section 195 provides that an exempted company that is not listed on CSX is prohibited from making any invitation to the public in the Cayman Islands to subscribe for any of its securities.

It is however the view of the Cayman Island Government that the stock exchange rules in the relevant jurisdiction will apply. The rationale for leaving this distinction between public and private companies to the operating level in this way derives from the fact that different jurisdictions have different rules about public companies, and that the rules of the relevant exchange will govern in any event. This approach has not raised any practical issues to date, we are advised.

Nevertheless we recommend that the CL should be amended to create a distinction between those companies which can offer their shares to the public and those which cannot and subject the former type of companies to a legal framework which complies with the Principles.

9.4.2.2 ***Private companies***

The preamble to the OECD Principles states that the Principles "to the extent that they are deemed applicable might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises".

In respect of companies whose shares may not be issued to the public (which, although there is no distinction in the CL, we call "private companies") we have assessed those aspects of the Principles which it is reasonable to apply.

We consider that the following sections of the Principles should, in the most part, apply to private companies:

- rights of shareholders (section I);
- equitable treatment of shareholders (section II); and
- responsibilities of the Board (section IV).

While it is recognised that these matters are partially covered by common law, we consider that the CL falls short of the Principles in a number of respects. For example, there are inadequate provisions concerning the protection of minority shareholder interests, potential conflicts of directors' interests and there are no insider trading or abusive self-dealing provisions.

9.4.3 **Audit**

9.4.3.1 ***Audit of accounts of public and publicly traded companies***

We consider that all public and publicly traded companies should, in line with OECD Principles, be required to prepare and submit annual audited accounts.

In the case of both public and publicly traded companies these accounts should be available to the public. There is no requirement under the CL for any company to prepare and file audited accounts in the Cayman Islands. We consider that the distinction should be made and that public companies should be required to file accounts audited and prepared in accordance with International Accounting Standards or an equivalent (eg US GAAP). This will require an amendment to the CL.

9.4.3.2 ***Audit of accounts of private companies***

We do not consider that, unless it is a regulated institution, a private company should be required to prepare and submit audited accounts as the cost and burden of such a requirement would outweigh the benefits.

We consider that it is open to the shareholders in a private company to require the accounts of the company to be audited. We consider it appropriate that the choice should be the shareholders to make. Similarly it is a matter for potential creditors and others who do business with such companies to determine whether they wish to require an audit as a condition of entering into a business relationship.

9.4.4 **Directors**

We consider that a number of steps need to be taken to facilitate compliance with the OECD Principles in this area.

The OECD Principles require the responsibilities of directors to be adequately set out. In many common law jurisdictions this is covered by common law rather than statute.

Provision should be made in legislation for the disqualification by the Court of directors who are not fit to be involved in the management of a company. This will reduce the use of so called "nominee" directors as a director can be held accountable for a failure to fulfil his duties. The concept of "nominee" director is not recognised in the legislation and it is important, therefore, that effective action can be taken against those who do not exercise their fiduciary duty as directors appropriately. This approach accords that taken in the "Review of Financial Regulation in the Crown Dependencies" (Section 11.1.4).

We consider that the names of directors of all Cayman Islands companies should form part of the publicly available information held at the Companies Registry.

There is also a need to address the issue of corporate directors. We consider that the use of corporate directors, whilst common in both on-shore and offshore jurisdictions, could lead to a failure to comply with the OECD Principles concerning the responsibilities of the board and, in particular, the key functions of the board, such as reviewing and guiding corporate strategy.

It would however be inappropriate to impose a restriction on the use of corporate directors in the OTs until such time as the matter is addressed on a multi-jurisdictional basis. We therefore recommend that corporate directors should continue to be permitted until such time as the issue is addressed internationally. However where corporate directors are provided by a company service provider, the CSP should be required to ensure that the directors' duties are being properly fulfilled. This is dealt with in the next section.

In summary, in respect of directors, we recommend that :

- particulars of directors should form part of the publicly available information held at the Companies Registry;
- those who provide directors by way of business should be required to take appropriate steps to ensure those directors are aware of their responsibilities and are suitable for the role; and
- there should be provision in the CL for a director to be disqualified on the grounds that he is not fit to be involved in the management of a company.

9.4.5 **Beneficial ownership**

An effective way to determine beneficial ownership is through a requirement to formally disclose this to the Registrar. We recognise, however, that this approach is not always practicable. As an alternative we consider good practice is met by requiring company service providers to be licensed and to be obliged to establish and record the beneficial ownership of the companies for whom they provide the management and administration service. Our proposals in respect of this are contained in the section on company service providers.

The requirements for establishing beneficial ownership are now covered by the client verification requirements contained in the Money Laundering Regulations 2000 and the Code of Practice. However, there must be a link between the Companies Management Law and the Money Laundering Regulations so that the regulator can enforce the requirements directly. For example, a breach of the Money Laundering Regulations could be express grounds for revocation of the licence. Recommendations in relation to this are covered in the section on Corporate Service Providers.

9.4.6 **Bearer shares**

Bearer shares and share warrants to bearer can provide a significant level of anonymity, which may be abused by those seeking to use companies for a criminal purpose. Furthermore, fictitious bearer shares can be used to perpetrate fraud. There are, however, legitimate reasons for the use of bearer shares and the issue of bearer shares or share warrants to bearer is permitted in many jurisdictions.

In the circumstances, we do not consider that good practice requires the issue of bearer shares and share warrants to bearer to be prohibited, but they must be controlled effectively to prevent abuse.

In our opinion, the issue of bearer shares in an exempted company, to an end client, is incompatible with good practice as the tracing of beneficial ownership may become impossible.

Therefore, we recommend that the CL be amended to require immobilisation of bearer shares as a condition of their issue, or otherwise effectively controlled to prevent abuse. We have been advised by the Cayman Islands' government that the Cayman Islands intend to introduce relevant legislation in 2001.

9.4.7 **Company registry**

We consider that the current filing backlog at the Registry should be addressed. We therefore recommend that a review of the work and available resources of the Registrar should be undertaken with a view to assessing proper staffing levels and action taken accordingly. We have been advised that the Registry is currently reviewing a project proposal for electronic document storage which it intends to implement shortly.

9.4.8 **Statutory registers**

As stated the CL does not entitle a member of an exempted company to inspect the register of members. We cannot see the justification for this, which is contrary to basic shareholder rights as outlined in Section I of the Principles.

We recommend that the CL is amended accordingly.

9.4.9 **Registered office**

As indicated, an exempted company may keep its register of members outside the Cayman Islands.

We consider that an exempted company should be required to keep its register of members, or an up-to-date copy thereof, in the Cayman Islands. It is an essential part of the audit trail and should be available within the jurisdiction.

We also consider that, in order that the audit trail is not broken, every Cayman Islands company should be required to keep at its registered office details of the location or locations where its books and records are kept.

We recommend that the CL is amended accordingly.

9.4.10 **Company names**

The Registrar currently has no general power to refuse the registration of a company on the grounds that he considers the name to be undesirable. We consider that he should be given that power.

9.4.11 **Enforcement powers**

We consider that the current powers of enforcement in the CL are inadequate. The following additional enforcement powers should be considered:

- the Registrar should be able to apply to the Court for the winding up of a company on the public interest ground; and
- it should be possible for the Registrar to initiate an investigation of the company by an inspector or, at least, make application to the Court for such an investigation. The power of the inspector should include the ability to obtain all relevant documents and interview under oath.

9.4.12 **Insolvency**

We consider that the insolvency and winding up provisions in the CL are inadequate as they do not contain many of the

features that we would expect to see in a modern piece of insolvency legislation. Areas in which we consider that the insolvency provisions are inadequate including the following:

- There are no rescue procedures, such as the administration and company and individual voluntary arrangement provision, in the UK Insolvency Act 1986;
- There are inadequate provisions for the avoidance of pre-liquidation transactions, such as those made at an undervalue; and
- The cross-border insolvency provisions are inadequate.

Consequently, we consider that the provisions in place for dealing with insolvent companies are inadequate.

We welcome your comments on this site.

Prepared 27 October 2000

10 Company service providers

10.1 Introduction

Company management business typically encompasses a number of activities, including:

- the formation of companies for clients;
- the provision of the registered office for companies;
- the provision of the registered agent for companies (in those jurisdictions the legislation of which provides for registered agents);
- the provision of nominee shareholders;
- the provision of director services; and
- the preparation and filing of statutory forms for companies.

In this Report we refer to those who undertake company management business as company service providers ("CSPs").

Most of the OTs have legislation which provides for the regulation of CSPs, although not necessarily covering all the above activities.

There are no international standards concerning the regulation and supervision of CSPs, a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either onshore or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of CSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide company services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed CSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the court to wind up a CSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a CSP's licence, as well as to pursue civil and criminal sanctions;
- CSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- CSPs, when providing director services, should be required to fulfil their responsibilities as directors and should not be permitted to abrogate their responsibilities through, for example, the use of general powers of attorney.

As indicated in the section on companies, the most practical and effective way of deterring the abuse of company structures and ensuring that relevant information is available to law enforcement authorities is through the regulation of CSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of CSPs in the Cayman Islands and our recommendations concerning enhancements are set out below.

10.2 Type and scale of activity

The Company Management Law, 1999 ("CML"), provides that no person, including an individual, may carry on the business of company management unless licensed under the CML.

As at 31 March 2000, there were 44 licensees under CML, all of which were limited liability companies.

10.3 **Factual assessment**

10.3.1 **Legislation**

The CML is the only legislation relating to the regulation and supervision of company management in the Cayman Islands.

The CML provides for the compulsory licensing of those engaged in company management business and for their on-going supervision by CIMA. The CML repeals and replaces the Companies Management Law (1998 Revision) which had similar scope and objectives.

The holders of the following licences are exempted from the CML in the circumstances set out in Section 5(2):

- the holder of a full trust licence issued under the Banks and Trust Companies Law;
- the holder of a restricted trust licence under BTCL;
- the holder of a nominee trust licence under BTCL, in respect of nominee services only;
- the holder of an insurers managers licence; and
- the holder of a mutual funds administrators licence.

For the purposes of the CML, company management business is defined as the provision for profit and reward and pursuant to a contract for services of:

- a director or alternate director for a company;
- an officer with control of the whole or a substantial part of the assets of a company;
- a nominee shareholder for an exempted limited duration company whose management is vested in its members; and
- other company managerial services involving the control of the whole or a substantial part of the assets of a company.

There are a number of exceptions to this definition including the provision of a director for the purposes of forming a company or holding board meetings in the Cayman Islands, the provision of services within a group of companies and the provision of services to a company listed on a recognised stock exchange.

Areas covered by the CML include:

- the granting and revocation of company management licences;
- the minimum net worth requirement for licensees;
- control of the use of names connoting the business of company management;
- the control of changes in ownership and directors of licensees;
- the duties of licensees;
- the ongoing supervision of licensees by CIMA; and
- enforcement powers.

Section 15 of the CML requires a licensee to maintain insurance cover in accordance with that section.

We are informed that the requirement of insurance cover is enforced in the initial application process and verification of on-going insurance coverage will be included in the biannual reporting form and confirmed during on-site inspections.

The CML is intended to regulate persons providing fiduciary services, rather than those carrying on traditional company management business. In particular, the following activities are not regulated under the CML, or at all:

- the formation of companies;
- the provision of registered office services for companies;
- the provision of nominee shareholder services (other than in respect of an exempted limited duration company whose management is vested in its members); and
- preparing and filing statutory documents on behalf of companies.

10.3.2 **Regulations, rules and guidance notes**

Regulations, updated in respect of the new CML of 1999, have been drafted and approved by CIMA and were gazetted on 31 July 2000.

CIMA provides guidance to licensees on a one-to-one basis as issues arise, however no formal guidance notes have been produced under the CML.

The Anti-Money Laundering Code of Practice covers CML licence holders and also applies to services relating to company registration and incorporation, the provision of the registered office for companies and the business of company management. The Anti-Money Laundering Code of Practice and the Money Laundering Regulations 2001 which also apply are discussed in the section on Money Laundering.

10.3.3 **Supervision - systems and procedures**

10.3.3.1 ***Regulatory structure***

The licensing authority for company managers is the Governor in Council.

Day-to-day supervision of company managers is undertaken by CIMA. At the time of our visit there was just one officer responsible for the supervision of all licensed company managers. That officer also had some responsibilities with regard to mutual funds.

10.3.3.2 ***Licensing process***

Application is made to the Governor in Council via CIMA in the prescribed form. An applicant for a licence is required to submit specific information including information on its authorised agents and evidence of appropriate company management experience. Character references are required for individual applicants, partners of partnership applicants and directors and officers in the case of corporate applicants. Police clearance certificates/affidavits of no convictions are also required.

CIMA reviews the application, makes such further enquiries and undertakes such checks as it considers appropriate and then makes a recommendation regarding the application to the Governor in Council for approval or otherwise.

The CML does not specifically require the applicant or its shareholders, directors or officers to be "fit and proper" although a licence may be revoked on these grounds. However, in practice CIMA operates such a test as part of the application process. Before approving a submission of a licence to the Governor in Council for consideration it is a practice of CIMA to have the proposed shareholders and directors vetted by the FRU and any person(s) considered by CIMA to be unsuitable would be rejected. In considering new applications for company management licences, the staff of CIMA use a checklist to ensure that all information and documentation has been provided. CIMA does not undertake vetting checks through international databases such as Lexus/Nexus or Dow Jones.

Before granting a licence, the Governor in Council must be satisfied that:

- the applicant has submitted an application in the prescribed form; and
- the application is not against the public interest.

10.3.3.3 ***Ongoing supervision***

Off-site

Every company manager is required to provide CIMA on an annual basis with:

- audited financial accounts;
- an auditors' certificate of compliance confirming that the licence is valid and whether or not the licensee has during the audit period, carried on its company management business in accordance with the information provided in its licence application; and
- an auditor's certificate of the existence of adequate procedures to ensure compliance by the licensee with the Anti-Money Laundering Code of Practice or any Code of Practice issued under the CML.

A biannual report, signed by a director or senior manager of the licensee is also required certifying that the information provided in the report is true and fair and that any material facts affecting the company's affairs will be disclosed to CIMA.

The above are reviewed by CIMA. There are no other requirements to provide information on an ongoing basis.

On-site

CIMA has power to conduct on-site inspections. This now includes powers to review client files without the client's permission or a Court order. Under Section 30 MAL as amended, CIMA also has the responsibility to monitor for compliance with the MLRs 2000.

An on-site inspection programme has commenced but we were advised by CIMA that it is not yet fully operational. A new Fiduciary Services Division (FSD) is being established to cover Trust Service Providers together with Company Managers and as soon as this new division is adequately resourced a programme of on-site inspections will be undertaken.

10.3.4 **Enforcement - systems and procedures**

The main powers of enforcement available under CML are as follows:

10.3.4.1 ***CIMA***

- CIMA may require a licensee to change the name under which it carries on company management business in the circumstances set out in that section;
- CIMA may require a licensee which is a company to remove any director or officer;
- CIMA has the power to undertake an examination of a licensee with a view, *inter alia*, to confirming that the licensee is in a sound financial position;
- where it appears to CIMA that an offence against the CML is being or has been committed, it may, with the approval of the Court, take action to preserve the assets held by the management company in a fiduciary capacity; and
- CIMA may, in the circumstances set out in the section, be granted a search warrant by the Court.

10.3.4.2 ***Governor in Council***

The Governor in Council may revoke a licensee's licence, direct the substitution of a director or senior officer of a licensee, appoint a person to advise the licensee on the proper conduct of his affairs or appoint a person to assume control of the licensee's affairs, if:

- the licensee becomes or is likely to become insolvent;
- has contravened any provision of the CML or has failed to comply with a condition of its licence;
- the licensee is carrying on business in a manner detrimental to the public interest or to the interest of his clients or creditors; or
- the licensee is not a fit and proper person to hold a licence.

- On the receipt of a report from a person appointed by the Governor in Council, the Governor in Council may apply to the Court for the winding up of the licensee.

10.3.4.3 ***International Co-Operation***

The Monetary Authority (Amendment) (International Co-operation) Law 2000 ("MAICL") and the consequential amendment to the CML, the Companies Management (Amendment) (Access to Information) Law 2000 ("CMAIL") enable CIMA to access client information and exchange client information with overseas regulatory authorities, the latter under certain conditions (see section 14).

10.4 **Issues and recommendations**

10.4.1 **Introduction**

We consider the existence of legislation covering company management to be a positive feature of the regulatory structure and one that exists only in a limited number of other jurisdictions.

The Cayman Islands have a reasonable regulatory structure in place for the supervision of certain types of company service provision.

However, the legislation is limited in scope to those CSPs who provide fiduciary services. Much traditional company management business, including the formation of companies and the provision of registered office services, is outside the scope of the legislation and of the regulatory net. We do not consider that this meets the good practice standards set out in the Guidance Notes.

Furthermore, the current supervisory process is in need of development. In particular, the limited supervisory resources and the lack of on-site supervision requires to be addressed.

Our recommendations concerning resourcing are contained in the section on the regulator. Our other recommendations concerning the regulations of CSPs are detailed below.

10.4.2 **Scope of the legislation**

As stated above, whilst the Cayman Islands have a regulatory regime in place for those engaged in a range of company management activities, the focus on the fiduciary activities of company management means that the regime is currently too restrictive to meet good practice standards. The CML will need to be expanded accordingly.

We therefore recommend that the CML should be reviewed and that its scope should be extended to include traditional company management activities, such as company formation and the provision of a registered office for companies. The CML will need to be expanded to cover the provision of other traditional types of company management business including nominee services and others that are not fiduciary services. Coverage should encompass where the service is provided to foreign as well as local companies.

10.4.3 **Regulatory supervision**

10.4.4 **Licensing process**

CIMA undertakes fit and proper checks and these are detailed above. However the CML does not formally require such checks. We consider it desirable to place the obligation of being "fit and proper" on a statutory footing by amending the legislation to reflect actual practice.

We consider that such a change would also bring this part of the CML into line with section 16 of the CML which provides the Governor in Council with enforcement powers where a CML licensee is not "fit and proper".

In considering new applications for CML licences the staff of CIMA use a checklist to ensure that all information and documentation has been provided. We recommend that the checklist is expanded into a more comprehensive applications manual which provides qualitative guidance on assessing an application, such as:

- assessing a business plan; and
- assessing and verifying references.

Although we do not consider that "four eyes" control should be an automatic requirement for every CSP, we consider that in the majority of cases it will be appropriate. We recommend, therefore, that as part of the review process for an application, CIMA should consider whether the business proposed to be undertaken by the applicant justifies the imposition of a requirement that at least two people will be involved in the operation of the CSP to provide support and oversight. Where a licence is granted to a CSP without requiring "four eyes" control, CIMA should keep the situation under review as it may subsequently become appropriate for him to impose such a requirement.

10.4.5 **Code of Conduct**

Regulations issued under the CML were gazetted on 31 July 2000. These regulations provide for the documentation and information which must be provided by an applicant for a CML licence.

CML licensees and persons providing company services not currently requiring a licence under the CML are subject to the Anti-Money Laundering Code of Practice and the Money Laundering Regulations 2000. As a result, such providers are required to have in place "know your customer" and record keeping procedures.

However, there are a number of other areas where we consider that additional requirements should be placed upon CML licensees. To facilitate the meeting of the international and good practice standards identified in the Guidance Notes, we consider that all CML licensees should be subject to an enforceable Code of Conduct. The Code of Conduct should include requirements relating to:

- the maintenance of the records in the jurisdiction;
- knowing the beneficial owner of a company on an ongoing basis;
- the suitability of directors provided by the licence holder;
- the mechanisms for ensuring the immobility of bearer shares;
- the provision of powers of attorney;
- the conduct of directors provided by licence holders;
- the segregation of client money and assets; and
- the provision of signing authorities to other persons including shareholders and beneficial owners of shares to a bank account of a company where the licence holder provides director services.

To the extent that the Money Laundering Regulations 2000 and the Code of Practice cover matters listed above, the Code of Conduct may simply make adherence to those a requirement, so providing enforcement powers for the regulator even if no criminal action is taken as a result of the breach of the Regulations.

10.4.5.1 ***Ongoing supervision***

Off-site

The CML provides CIMA with a legislative framework which should enable it to carry out an effective off-site review process. Given that the legislation is still relatively new, it is not possible to assess how well it is being applied by CIMA. However, it is our view that the current staffing levels cannot support the level of off-site supervision which should take place to fulfil the international and good practice standards contained in the Guidance Notes.

CIMA agree with this point and have confirmed to us that they are beginning recruitment as a first step to addressing these issues. We have also been advised by CIMA that an off-site review checklist (enhancement of off-site review which will include financial reporting, due diligence, know your customer and segregation of client monies and source of funds) is now being addressed.

On-site

Although CIMA has commenced an on-site inspection programme in respect of company managers, we do not consider that it is fully effective for the reasons set out below.

One officer is responsible for the supervision of CML licensees. We do not consider that this level of staffing is adequate to

support an effective on-site supervision programme.

We do not consider that CIMA would have been able to carry out effective on-site inspection without access to client files to test the processes and procedures of the licensee and to ensure that the CML and the Code of Conduct (when issued) are being complied with. We therefore welcome the recent changes to the legislation to permit this.

We consider that the enforceable Code of Conduct should replace the Code of Conduct produced by the Company Managers' Association.

10.4.6 **Enforcement of regulations**

We consider that the CML provides sufficient enforcement powers, although they should all be vested in CIMA.

10.4.7 **Bearer shares**

We know from our discussions with representatives of the private sector that bearer shares in exempted companies are issued to end clients, though we are informed the practice is not common. The issue of such shares without any control being exercised is contrary to good practice as it is difficult, if not impossible, to ascertain the beneficial owner of the company at any given time.

Most company managers in the Cayman Islands will not issue bearer shares where they provide fiduciary services unless they retain control over the bearer shares.

However, where an exempted company is incorporated and the company manager does not provide director services, the directors can issue bearer shares without the knowledge of the company manager.

Whilst we are not persuaded that international practice and standards require the outright prohibition of bearer shares, we consider that their use must be strictly controlled. The appropriate method of achieving this is to regulate their issue by amendment to the Companies Law. We therefore consider that the Companies Law should be modified to require that bearer shares may only be issued if they are immobilised. This is covered in the section of this Report on companies.

The immobilised share must either be retained by the licence holder or by someone acting on his authority. The details of the requirement should be contained in the regulations issued under the CML.

If this cannot be achieved, consideration should be given to prohibiting the use of bearer shares.

The Cayman Islands' government has indicated that legislation dealing with the control of bearer shares will be introduced in 2001.

We welcome your comments on this site.

Prepared 27 October 2000

11 Partnerships

11.1 Introduction

The legislation in all of the OTs provides for two different types of partnership, ordinary or general partnerships and limited partnerships. None of the OTs have legislation in place that provides for the formation of limited liability partnerships ie partnerships which are separate legal entities where, unlike limited partnerships, the limited partners are permitted to take part in the management of the business which and are primarily used as vehicles for professional firms.

11.1.1.1 *Ordinary partnerships*

The ordinary partnership legislation of those OTs that have it is based upon the UK Partnership Act. Neither the UK Partnership Act nor the OT partnership legislation establishes supervisory regimes. The legislation typically sets out the rules for determining the existence of a partnership and governs, to a limited extent, the relationship between partners and between the partnership and third parties. Ordinary partnerships are not subject to registration in any of the OTs. The liability of all partners in an ordinary partnership is unlimited.

Ordinary partnerships are formed almost exclusively by domestic businesses in the OTs usually where the business is small or where the members of a particular profession are prohibited from carrying on business through a limited liability company.

As ordinary partnerships are not generally used for offshore purposes we do not consider that they fall within our TOR and we have not covered them in our review. In so far as ordinary partnership, such as lawyers and accountants, also act as company or trust service providers their role is dealt with in those sections of this Report.

11.1.2 Limited partnerships

Limited partnerships enable the liabilities of "sleeping partners" to be limited to their capital contribution provided that they do not take part in the management of the partnership. They are used typically in investment schemes to limit the liability of investors without giving them ownership of a share in a company. They are also used in estate planning schemes.

The TOR and the Guidance Notes require us to determine whether the legislation, framework and systems in place in each OT conform to good practice having regard, in particular, to FATF and CFATF Recommendations, the OECD Principles of Corporate Governance ("the OECD Principles") and the G22 Report on Transparency and Accountability.

There are no international standards that relate specifically to the supervision of limited partnerships. We have therefore considered the appropriateness of the above general standards for limited partnerships. It is our view that:

- the FATF and CFATF Recommendations that are of primary relevance to limited partnerships are those that concern "know your customer" and record keeping procedures;
- the OECD Principles are designed primarily for publicly traded corporations and are not appropriate to limited partnerships; and
- the G22 Report on Transparency and Accountability is not applicable to limited partnerships.

Due to the limited liability given to limited partners, limited partnerships are attractive offshore vehicles and, in common with all offshore vehicles, are subject to potential abuse by money launderers and other criminals. We therefore consider that good practice requires that, in the event that a limited partnership is suspected of being involved in criminal activity, the law enforcement authorities should be able to access information concerning both the limited and general partners. This approach was envisaged by the Guidance Notes.

We also consider that the business of:

- forming limited partnerships;

- providing a registered office for limited partnerships; and
- acting as a registered agent

should be regarded as financial services. As such, it is important that high standards are maintained for the protection of clients. Subject to special circumstances, we consider that good practice standards require that these activities should be regulated.

11.2 Type and scale of activity

There are two types of partnership provided for under Cayman Islands law, general partnerships and limited partnerships. A limited partnership may register as an exempted limited partnership.

As at 31 December 1999 1,586 limited and exempted limited partnerships were registered in the Cayman Islands.

No statistics are kept on the type of business carried on by partnerships in the Cayman Islands. The description of the nature of the partnership business provided in the declaration or statement filed will usually be too general to enable useful statistics to be collated.

11.3 Factual assessment

11.3.1 Legislation

The Cayman Islands has two pieces of legislation concerning partnerships. These are:

- The Partnership Law (26 of 1983) (1995 Revision); and
- The Exempted Limited Partnership Law (1997 Revision).

11.3.1.1 *The Partnership Law ("PL")*

For the reasons set out in the introduction, we have not considered the PL insofar as it relates to ordinary partnerships. Part VI of the PL provides for limited partnerships.

Limited partnerships are similar to exempted limited partnerships (see below).

11.3.1.2 *The Exempted Limited Partnership Law ("ELPL")*

The Exempted Limited Partnership Law permits the formation of exempted limited partnerships and their registration by the Registrar of Exempted Limited Partnerships. Exempted limited partnerships consist of one or more general partners and one or more limited partners. The provisions are similar to the limited partnership legislation found in the US State of Delaware.

The general partners carry on the business of the partnership and have the same liabilities and responsibilities as partners in a general partnership. Limited partners contribute or undertake to contribute capital to the partnership and their liability is limited to the capital that they have contributed or undertaken to contribute. A limited partner is not permitted to take part in the management of an exempted limited partnership. To the extent that he does, he is liable, in the event of the insolvency of the partnership, for all debts and obligations of the partnership incurred whilst he was taking part in the management of the partnership, to any person dealing with the partnership who had actual knowledge of his participation and who believed him to be a general partner.

An exempted limited partnership must have a registered office in the Cayman Islands.

At least one general partner must be an individual resident in the Cayman Islands, a company registered under the Companies Law or another exempted limited partnership.

Under Section 17 of the Exempted Limited Partnership Law, the Governor in Council may give an undertaking to an exempted limited partnership that no fiscal law enacted in the Cayman Islands will apply to an exempted limited partnership.

Unless inconsistent with the Exempted Limited Partnerships Law, the Partnership Law (except for Part VI) applies to exempted limited partnerships.

11.3.2 Regulations, Rules and other Guidance

11.3.2.1 ***The Partnership (Fees) Regulations (1989 Revision)***

These regulations prescribe certain fees payable in respect of limited partnerships.

11.3.2.2 ***The Exempted Limited Partnership Regulations (1999 Revision)***

These regulations prescribe certain fees payable in respect of exempted limited partnerships and provide the form of the Governor in Council's undertaking in respect of the non-applicability of fiscal laws.

11.3.2.3 ***Guidance***

No guidance has been issued in respect of limited or exempted limited partnerships.

11.3.3 **The formation and registration of limited and exempted limited partnerships**

Limited partnerships and exempted limited partnerships must be registered with the Registrar of Companies ("the Registrar") who also acts as Registrar of Limited Partnerships and as Registrar of Exempted Limited Partnerships.

Registration involves filing a declaration (limited partnership) or statement (exempted limited partnership) with the Registrar signed by or on behalf of the general partner and containing basic information concerning the partnership and its partners.

The declaration filed by a limited partnership must also set out the amount of capital contributed by each limited partner and a statement that the contribution has been paid in cash.

The statement filed by an exempted limited partnership must contain a declaration that the partnership will not undertake business with the public in the Cayman Islands, other than as necessary to carry on its business outside the Cayman Islands.

A partnership that is not registered as a limited partnership or an exempted limited partnership is deemed to be a general partnership.

The information contained in the declaration filed in respect of a limited partnership is published in the Gazette.

Persons who carry on the business of forming limited and exempted limited partnerships or providing the registered office for limited and exempted limited partnerships are not, in that capacity, currently regulated and they are not subject to the anti-money laundering Code of Practice.

Until a partnership is registered as a limited partnership, the partners will not obtain the benefit of limited liability.

11.3.4 **Supervision - systems and procedures**

11.3.4.1 ***Regulatory structure***

Details of the structure and resources of the Registrar and Companies Registry are provided in the section of this Report on Companies.

11.3.4.2 ***On-going supervision***

In common with other jurisdictions, there is no on-going supervision of limited or exempted limited partnerships.

11.3.5 **Enforcement - systems and procedures**

There are currently no specific enforcement procedures available in respect of limited or exempted limited partnerships, although certain breaches of the partnership laws are offences that are punishable by a fine.

11.3.6 **Publicly available information**

11.3.6.1 ***Information held by the Registrar***

The information contained in the register of limited partnerships maintained by the Registrar covers the following:

- the general nature of business of the partnership;
- the principal place of business (limited partnership);

- the registered office in the Cayman Islands (exempted limited partnership);
- the name and address of all partners (limited partnership);
- the name and address of general partners (exempted limited partnership); and
- the term of the partnership and its commencement date.

A limited and an exempted limited partnership is required to inform the Registrar of changes in any of the above details.

An exempted limited partnership is also required to file an annual return with the Registrar.

The registers of limited and exempted limited partnerships are open to public inspection.

11.3.6.2 ***Information held at the registered office***

The general partners of an exempted limited partnership must keep a register containing:

- the name and address of each limited partner;
- the amount and dates of contributions of each limited partner; and
- the amount and date of any payment representing a return of any part of a partner's contribution

at the registered office of the partnership.

The register of limited partnership interests of an exempted limited partnership is open to public inspection.

There is no similar requirement in respect of a limited partnership.

11.3.7 **Non-public information**

There is no requirement that an exempted limited partnership keep any accounting or any other books or records.

11.4 **Issues and recommendations**

11.4.1 **Introduction**

In accordance with our interpretation of our TOR, we are required to assess whether:

- in the event that a limited partnership is used or suspected of being used for criminal purposes, the law enforcement authorities in the Cayman Islands is able to obtain basic information concerning the partnership, such as the identity of the general and limited partners;
- the identity of general and limited partners of limited partnerships in the Cayman Islands has been ascertained through the usual "know your customer" procedures; and
- adequate procedures are in place to protect the interests of partnerships utilising professional service providers in the Cayman Islands.

For the reasons set out in the following paragraphs we are of the view that in some respects the Cayman Islands meets the good practice standards set out in the Guidance Notes but that it does not meet all of them.

Our recommendations follow.

11.4.1.1 ***Availability of information to law enforcement authorities***

The information required to be filed with the Registrar in respect of limited and exempted limited partnerships is set out in section 11.3.6.1. This includes basic information, but it does not include details of the limited partners of exempted limited partnerships or the capital contributions of limited partners of either limited or exempted limited partnerships.

The information filed is available to the public and therefore readily accessible to the law enforcement authorities in the Cayman Islands.

We do not consider that good practice requires that information concerning the limited partners and their capital contributions should be filed at the Registry provided that the information is available in the Cayman Islands.

We are of the opinion that the legislative requirements prescribing the information and records to be kept in the Cayman Islands meet good practice standards. Of course the quality of the information will be dependent upon:

- the due diligence checks undertaken with regard to partners; and
- the degree of compliance with regard to the other record keeping requirements.

11.4.1.2 ***Application of know your customer and recording keeping requirements***

In order to comply with FATF and CFATF Recommendations, we consider that persons who provide the service of forming limited and exempted limited partnerships and those who provide the registered office of limited partnerships should be subject to the usual know your customer and record keeping requirements.

This is not currently the case, and we therefore recommend that the Money Laundering Regulations 2000 should cover any persons who, as part of their business:

- form limited or exempted limited partnerships; or
- provide the registered office of limited or exempted limited partnerships.

11.4.1.3 ***Regulation of professional service providers***

We are of the opinion that persons who form limited or exempted limited partnerships or provide registered office services for limited or exempted limited partnerships should be considered as financial service providers and subject to regulation. The objectives of regulation are as follows:

- the maintenance of standards generally that will protect partnerships using the service providers; and
- the maintenance of high record keeping standards so that records required to be kept at the registered office are maintained in good form so that they are of value to the law enforcement agencies, if required.

We therefore recommend that such persons are subject to an appropriate regulatory regime or that only licensed company managers or trust companies are permitted to provide registered office services or form limited or exempted limited partnerships.

Some jurisdictions provide for the appointment of a registered agent. We consider that this is desirable and recommend that limited partnerships should be required to appoint a registered agent.

11.4.1.4 ***Other areas for improvement***

The Registrar currently has no enforcement powers with respect to limited and exempted limited partnerships. We consider that this does not comply with good practice standards.

We consider that the Registrar should be able to apply to the Court for the dissolution of a limited and exempted limited partnership and/or for the appointment of an inspector in appropriate circumstances. These circumstances should include fraud, insolvency or other reason of public interest.

We suggest that a procedure for the appointment of an inspector is established in a way that it analogous to the appointment of an inspector under the Companies Law.

There is no requirement that an exempted limited partnership maintain accounting records. We consider that there should be. We recommend that all exempted limited partnerships should, at a minimum, be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership.

We do not consider that the accounting records of a limited or an exempted limited partnership need to be kept within the jurisdiction provided that a written record of the location where the records is held at the registered office of the partnership. This will ensure that in the event of a criminal investigation the audit trail is not broken.

We welcome your comments on this site.

Prepared 27 October 2000

12 Trusts

12.1 Introduction

Trusts are commonly used in offshore structures. They typically involve settlors, trustees and beneficiaries and often involve protectors, enforcers and custodians.

The settlor of a trust [2] is the person who transfers ownership of his 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.

The trustees of a trust hold legal title to the trust property. They must keep trust property separate from their own property. 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 invite and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes.

All trusts (other than purpose trusts) must have beneficiaries who may include the settlor. The trustees must account to the beneficiaries for what they do with the trust property. The beneficiaries are entitled to enforce implementation of the trust deed. A trust may be settled without existing beneficiaries provided that a beneficiary is or beneficiaries are ultimately ascertainable.

A trust may have a protector who will typically have powers to veto the trustees' proposals or remove them. A purpose trust is a trust for a particular purpose or purposes. Most of the OTs permit charitable and non-charitable purpose trusts.

An enforcer is the person who has the power to enforce a purpose trust.

A custodian trustee holds the trust property to the order of the managing trustee.

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the TOR. The TOR therefore require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for the criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries and protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary because a proper consideration of the above issues involves both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the "Review of Financial Regulation in the Crown Dependencies" (Section 12.9.5). Our recommendations concerning professional trust providers in

the Cayman Islands is contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of the Cayman Islands is required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not, in this Report, concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

12.2 **Type and scale of activity**

There are no requirements for trusts to be registered or reported in the Cayman Islands, although trusts may optionally be registered as exempted trusts.

Trust company returns to CIMA indicate that banks and trust companies licensed in the Cayman Islands is trustees of approximately 25,000 trusts.

It is not possible to provide any estimate of the net value of trusts administered in the Cayman Islands as CIMA is not required to and does not collect statistical information on this.

CIMA estimates that a sizeable and increasing proportion of the client base for trust services is corporate.

12.3 **Factual assessment**

12.3.1 **Legislation**

The principal legislation relating to trusts in the Cayman Islands is:

- the Trusts Law (1998 Revision);
- the Special Trusts (Alternative Regime) Law, 1997;
- the Perpetuities Law (7 of 1995) (1999 Revision);
- the Property (Miscellaneous Provisions) Law 1994;
- the Fraudulent Dispositions Law (15 of 1989) (1996 Revision).

12.3.1.1 ***The Trusts Law ("TL")***

The TL makes general provision for trusts in the Cayman Islands and provides for the duties and powers of trustees.

Although there are differences, the TL is broadly equivalent to the English Trustee Act 1925.

Exempted trusts are eligible to obtain a "Tax Undertaking" for up to 50 years which provides an exemption from any tax that may be imposed upon trusts in the future.

12.3.1.2 ***The Special Trusts (Alternative Regime) Law ("STAR Law")***

The STAR Law governs non-charitable purpose trusts in the Cayman Islands ("STAR trusts").

It provides that at least one of the trustees of a STAR trust must be a trust corporation licensed under the Banks and Trust Companies Law. The trust corporation is required to keep the following information in the Cayman Islands:

- concerning the trust;
- the identity of the trustees and the enforcer;
- settlements under the trust and the identity of the settlor;
- the property subject to the trust at the end of each accounting year; and
- all distributions or applications of the trust property.

A purpose trust must have an enforcer.

12.3.1.3 ***The Perpetuities Law ("PL")***

The PL is broadly equivalent to the English Perpetuities and Accumulations Act 1964.

12.3.1.4 ***The Fraudulent Dispositions Law ("FDL")***

Although not specifically designed to do so, the FSL establishes the framework within which asset or creditor protection trust must operate.

The Law provides that a disposition of property made with an intent to defraud and at an undervalue is voidable by a creditor who is prejudiced provided that proceedings are commenced within six years of the date of the disposition.

If a creditor is successful, only so much of the transfer as is required to satisfy the obligation to that creditor is affected.

12.3.2 **Regulations, rules and guidance notes**

There are no relevant regulations, rules or guidance notes relating to trusts.

12.3.3 **Supervision and enforcement - systems and procedures**

In common with other jurisdictions, trusts are not subject to regulation by a regulatory authority in the Cayman Islands. There is, therefore, no requirement for trustees, beneficiaries, custodians or protectors of Cayman Islands trusts to be notified to any central authority.

Trustees do, however, have a number of duties imposed on them under the TL and duties imposed on a trustee under English common law would be imposed on trustees by the courts in the Cayman Islands.

As indicated, trusts may, optionally, be registered with the Registrar of Trusts as exempted trusts.

12.4 **Issues and recommendations**

12.4.1 **Introduction**

Trust legislation in the Cayman Islands is similar to the trust legislation in a number of other jurisdictions, including England. In general, we do not consider that there are any particular features of the TL that are likely to lead to trust structures in the Cayman Islands being any more or less attractive to criminals or money launderers than trusts in other jurisdictions.

We consider that the STAR Law provides excellent protection in respect of non-charitable trusts and exceeds good practice standards. In respect of asset or creditor protection trusts and purpose trusts, we consider that the Cayman Islands legislation is conservative and meets good practice standards.

12.4.2 **Preventing the abuse of trusts**

As indicated in the Introduction to this section, we consider that the most practical and effective way to prevent the abuse of trusts is through the regulation of trust service providers. We consider that all persons providing trust services for profit should be regulated. Our recommendations concerning this are set out in the next section. We do not consider that any changes to the TL are required to support this.

We are concerned, however, that the use of purpose trusts may be open to abuse. Purpose trusts have no beneficiaries to take action against trustees who are in breach of their duties and there is therefore a possibility of abuse by the trustees.

However, the STAR Law provides that:

- all STAR trusts must have an enforcer;
- at least one of the trustees of a STAR trust must be a licensee under the BTCL; and
- that records concerning the STAR trust are required to be kept in the Cayman Islands.

We consider that the protections contained in the STAR Law exceed good practice standards and that they will substantially reduce the risk of the abuse of purpose trusts.

12.4.3 **Establishing the true owner of trust assets**

In general, beneficial ownership of assets held in an express trust may be clear and ascertainable. However, this may not necessarily be the case for a discretionary or purpose trust or where the trustees may exercise discretionary powers.

We consider that, in the case of trusts administered by a professional trust service provider, law enforcement and regulatory authorities must, in appropriate circumstances, be able to identify the settlor, trustees, beneficiaries, protector and custodian and have access to the trust instrument and other relevant documentation concerning the trust.

This requires that the relevant documentation and information is kept within the jurisdiction. In respect of trust service providers, this is covered in the next section. This is not a general trust issue and we do not, therefore, consider that the TL requires any amendment in this respect.

In our opinion, international standards require that professional trust service providers should be required to put in place effective anti-money laundering measures, including know your customer, record keeping and staff training procedures.

Our recommendations concerning this are in the sections on money laundering and trust service providers.

We do not consider that it is appropriate to deal with this matter in the TL as the TL is not supervisory in nature.

12.4.4 **Transparency of financial arrangements**

The Guidance Notes indicate:

- that basic financial information relevant to the activities of trusts should be available to law enforcement and regulatory authorities; and
- that trustees should, ideally, be held accountable to beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector, where applicable.

We are further asked to consider in what circumstances it would be appropriate for accounts to be produced, whether accounts should be made public, in which circumstances abbreviated accounts might be acceptable and in which circumstances the requirement to produce accounts should not be applied.

We consider that professional trust service providers should be required to maintain proper financial records and that these should be available for inspection by the protector and beneficiaries (where appropriate). We also consider that these records should be available to law enforcement authorities where required in a criminal investigation. Our recommendations concerning this are contained in the next section of this Report.

However, we do not consider that trust accounts should be made public as they are private arrangements. Furthermore, we consider that requiring the preparation of accounts and their subsequent audit may be regarded by some clients as an unnecessary cost burden. In our view it should be for the client to determine whether he wishes accounts to be prepared and audited. It is not the role of legislation to impose it. Nevertheless we believe that the preparation and, where appropriate, auditing of trust accounts, is of benefit as it reduces the risk of mis-appropriation of trust assets.

12.4.5 **Removal of impediments to asset tracing and seizure**

This is considered further in the section on money laundering.

There is nothing in the legislation to prevent a "flee" clause being included in a trust deed, the effect of which may be to frustrate the seizure of assets emanating from a criminal source.

We therefore recommend that as "flee" clauses are an issue of general application, trust legislation should be amended to restrict their use.

12.4.6 **Asset or creditor protection trusts**

The Guidance Notes also require us to consider whether the claims of creditors in the OTs can be defeated through trust structures. The relevant legislation in the Cayman Islands is the FDL.

We consider that the six year limitation period, in comparison with equivalent legislation in other offshore jurisdictions, is conservative and meets good practice standards.

2 The descriptions of settlors, trustees, beneficiaries, protectors, enforcers and custodians are based on those set out in the "Review of Financial Regulation in the Crown Dependencies" which we consider provide excellent summaries. Back

We welcome your comments on this site.

Prepared 27 October 2000

13 Trust service providers

13.1 Introduction

There are no international standards concerning the regulation and supervision of trust service providers ("TSPs"), a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either on or offshore regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of TSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide trust services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed TSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the Court to wind up a TSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a TSP's licence, as well as to pursue civil and criminal sanctions;
- TSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the settlor, beneficiaries, protector and the custodian (where applicable) of a trust and to obtain a copy of the trust instrument;
- law enforcement and regulatory authorities should be able to access financial information relevant to the activities of trusts administered by a TSP; and
- trustees should be held accountable to the beneficiaries and settlor, and the protector, where applicable, by preparing regular accounts, where appropriate.

As indicated in the section on trusts, the most practical and effective way of deterring the abuse of trusts and ensuring that relevant information is available to law enforcement authorities is through the regulation of TSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of TSPs in the Cayman Islands and our recommendations concerning enhancements is set out below.

13.2 Type and scale of activity

Every trust company that carries on trust business from within the Cayman Islands must be licensed under the Banks and Trust Companies Law (2000 Revision) ("BTCL").

As at 31 March 2000, trust company licences in the following categories had been issued:

Category of Licence	Number of Licences
Bank & Trust (full)	
Bank & Trust (restricted)	2
Banking (restricted) & Trust (restricted)	2
Trust (full)	51
Trust (restricted)	62

CIMA advises that the majority of licensed trust companies are multi-jurisdictional bank and trust companies headquartered outside the Cayman Islands.

Individuals and partnerships carrying on trust business are not required to be licensed under the BTCL and are not regulated under any other Law. There is no statistical information on the amount of unregulated trust business carried on in the Cayman Islands.

13.3 **Factual assessment**

13.3.1 **Legislation**

The following legislation governs or relates to the regulation of trust business in the Cayman Islands:

- the BTCL (2000 revision) ("BTCL");
- the Monetary Authority Law (1998 Revision) ("MAL").

13.3.1.1 ***BTCL***

The BTCL covers both banking and trust companies. In this section we are concerned with only those provisions of the BCTL that relate to trust companies.

The legislation provides for the licensing of trust companies that carry on trust business, which is defined in Section 2 as the business of acting as trustee, executor or administrator.

Trust licences are either full, restricted or nominee.

A full trust licence enables a trust company to carry on trust business without any restrictions.

A trust company holding a restricted trust licence must not undertake trust business for persons other than those listed in any undertaking accompanying the application for the licence.

A nominee trust licence may be granted to the wholly owned subsidiary of another licensee where the sole purpose of that subsidiary is to act as the nominee of its parent.

Areas covered by the BTCL include:

- granting, surrender and revocation of trust licences;
- minimum net worth for licensee;
- control of changes in ownership of shares in a trust company;
- control of the use of specified words (eg trust) in a name;
- control of appointment of directors;
- duties of CIMA in relation to the regulation of trust business;
- duties of a licensee;
- ongoing supervision of licensees;
- enforcement powers.
- powers of the Governor in Council;
- immunity in respect of activities undertaken in the exercise of powers under the BTCL.

The Monetary Authority (Amendment) (International Co-operation) Law 2000 ("MAICL") and the consequential amendment to the BTCL, the Banks and Trust Companies (Amendment) (Access to Information) Law 2000 ("BTCAIL") enable CIMA to access client information and exchange client information with overseas regulatory authorities, the latter under certain conditions (see Section 14 of this report for details).

13.3.1.2 ***MAL***

Section 30 of the MAL as amended by the MAICL, and the BTCAIL now allow CIMA access to client information. By virtue of Section 42(1) of the MAL a director, officer, employee, agent or adviser of the Monetary Authority is prohibited from disclosing any information relating to any application made to the Monetary Authority or to the affairs of a trust company or a customer or client of a trust company except as provided in Section 42(2).

13.3.2 **Rules and Regulations**

The following regulations have been made under the BTCL:

13.3.2.1 ***The Banks and Trust Companies (Designation) Order (1998 Revision)***

This order designates the Financial Secretary to exercise the powers of the Governor in Council to approve the issue, transfer or disposition of shares in a licensee under the BTCL, where there is no change in the control or ultimate beneficial ownership of the licensee.

13.3.2.2 ***The Banks and Trust Companies (Licence Applications and Fees) Regulations (1998 Revision)***

These regulations, which were amended in 1998, prescribe fees payable by a licensee under the BTCL and specify the information and documentation that must be provided on an application for a licence under the BTCL.

13.3.3 **Guidance**

No guidance has been produced under the BTCL specifically in relation to trust business.

General Guidance notes on licensing requirements and procedures have been issued to all licence holders under the BTCL, including trust companies.

The Anti-Money Laundering Code of Practice and the MLRs 2000 apply to all persons undertaking trustee services within a business relationship. This clearly includes trust companies. The Code of Practice and the MLRs are discussed in the Section on Money Laundering.

13.3.4 **Supervision - systems and procedures**

13.3.4.1 ***Regulatory resources***

The licensing authority for trust companies is the Governor in Council with recommendations on licensing being made by CIMA after their assessment of an application.

Day-to-day supervision of trust companies is undertaken by CIMA. Responsibilities within CIMA are undertaken by the banking department, details of which are contained in Section 3 to this report.

13.3.5 **Application process**

Application is made to the Governor in Council via CIMA. CIMA reviews the application, makes such further enquiries and undertakes such checks as it considers appropriate and makes recommendations to the Governor in Council for approval or otherwise.

A licence may not be granted to a trust company unless:

- the Governor in Council is satisfied that the carrying on of trust business by the trust company will not be against the public interest;
- it has a place of business in the Cayman Islands, approved by the Monetary Authority, which will be its principal place of business in the Cayman Islands; and
- it has two individuals or a body corporate, approved by the Monetary Authority, resident or incorporated in the Cayman Islands as its authorised agent.

Whilst there is no specific fit and proper test under the BTCL or the regulations which applicants must meet in practice CIMA undertakes such a test.

Applicants for a licence are required to include information on and financial references for the applicant, police clearance certificate, the identity of its authorised agent, evidence of appropriate trust business experience, a business plan and evidence of fully paid up capital in the requisite amount. Character and financial references and a police certificate are required for shareholders holding more than 2% of the share capital, directors and officers.

13.3.6 **Ongoing Supervision**

Every trust company, including a restricted trust company, is required to provide CIMA on an annual basis with audited financial accounts.

CIMA has commenced an on-site inspection programme in respect of trust companies.

The MAICL amended section 30 of the MAL to require that CIMA monitor compliance with the Money Laundering Regulations 2000.

13.3.7 **Enforcement - systems and procedures**

Under Section 8(5) of the BTCL, the Governor in Council may revoke the licence of a trust company with a name prohibited by that section.

If a licensee is, or appears likely to, become insolvent, is carrying on business in a manner detrimental to the public interest, the interests of the beneficiaries of any trust, or to the interests of its creditors, has contravened any provision of the BTCL or has failed to comply with a condition of its licence, the Governor in Council may:

- revoke the licence;
- impose new or additional conditions on the licence;
- substitute any director or officer of the licensee;
- appoint a person to advise the licensee on the proper conduct of its affairs, and to make a report to the Authority;
- appoint a person to assume control of the licensee's affairs; and
- require such action to be taken by the licensee as the Governor in Council thinks fit.

Where the Governor in Council receives a report from a person appointed to advise the licensee or to assume control of the licensee, he may revoke the licence and apply to the Court for the winding up of the licensee. The Governor in Council may also revoke the licence of a trust company if it has ceased to carry on business or it goes into liquidation.

Under Section 18, CIMA may apply to a Justice of the Peace for a search warrant where there is reasonable ground for suspecting that an offence under BTCL has been committed.

Under section 17 of the BTCL the Governor in Council may apply to the Court for a trust company to be wound up on the grounds of public interest or in the interests of the beneficiaries of any trust or the trust company's creditors.

13.3.8 **International Co-operation**

Section 42(3) and (4) MAL as amended by the MAICL now allows CIMA an appropriate gateway for co-operating with overseas regulatory authorities.

13.4 **Issues and recommendations**

13.4.1 **Introduction**

Unlike a number of jurisdictions, both onshore and offshore, the Cayman Islands regulate the provision of trust services and therefore are already addressing many areas of good practice. Furthermore the Cayman Islands substantially meet the requirements set out in the Guidance Notes. They have in place a regulatory environment for the supervision of trust service providers and these providers are subject to the Cayman Islands anti-money laundering provisions.

There are however some improvements that need to be actioned to bring the jurisdiction into full compliance with the Guidance Notes and these are detailed below.

13.4.2 **Exclusion of individuals and partnerships**

The terms of reference state that those who provide trust services should be licensed and subject to effective regulation. As indicated, individuals and partnerships are currently excluded from the BTCL and are therefore unregulated. It should be noted, however that CIMA consider that the numbers falling into this category are extremely small when compared to the regulated sector.

Both CIMA and representatives of the private sector advised us that, apart from licensed trust companies, trust business is only undertaken by law firms. It is argued that it is not necessary for law firms to be regulated in their conduct of trust business as it is an area of traditional legal practice.

Nevertheless, we consider that individual and partnership trust service providers should be subject to regulation by CIMA for a number of reasons, including the following:

- development of practices and procedures for the regulation of legal practitioners is at an early stage and does not encompass the regulation of trust business;
- even if trust business was to be brought within the regulation of legal practitioners, we consider it to be more appropriate for CIMA to regulate all trust service providers to ensure a consistent approach; and
- CIMA, as the primary regulator of trust business, should have access to market information in respect of all trust business.

We recommend, therefore, that all persons providing trust services as part of their business except where such service is purely as legal adviser should be subject to regulation by CIMA.

13.4.3 **Restricted Trusts**

Section 5(5)(e) of BTCL prohibits the holder of a restricted trust licence from undertaking trust business for persons "other than those listed in any undertaking accompanying the application". Although we consider that the word "person" is vague, CIMA have advised us that, in practice, it requires an applicant for a restricted trust licence to give an undertaking that they will only provide trust services for settlors identified in the business plan. We consider this to be satisfactory but recommend that, to assist transparency of process, guidelines are issued to this effect.

13.4.4 **Regulatory supervision**

13.4.4.1 ***Application Process***

Section 5 of the BTCL prescribes information required from an applicant by reference to the Banks and Trust Companies (Licence Applications and Fees) Regulations (1998 Revision). Sections 9 and 10 of the Regulations specify information and documentation that must be provided on an application for a licence. Requirements cover, *inter alia*, character references, police clearance certificate, evidence of good financial standing of each shareholder and evidence of adequate professional knowledge.

Whilst section 5 of the BTCL prescribes the information required by referring to the regulations, we recommend a revision to the BTCL which places the obligation of being "fit and proper" on a stronger statutory footing. This amendment reflects the current practice of CIMA

There should also be a requirement that at least two people are involved in the operation of a licence holder ("four eyes" control), so providing support and oversight.

In considering new applications for trust licences, the staff of CIMA use a checklist to ensure that all information and documentation has been provided. We recommend that the checklist is expanded into a more comprehensive applications manual which provides qualitative guidance on assessing an application and includes, for example, guidance on:

- assessing a business plan; and
- assessing and verifying references.

13.4.4.2 ***Off-site supervision***

We consider that there should be enhancements to the off-site review process. This should include the requirement for

regular compliance returns from the licence holder which should be subject to periodic review.

13.4.4.3 ***On-site supervision***

The Monetary Authority has commenced an on-site inspection programme in respect of trust companies. We were advised that as at 17 April 2000, CIMA had undertaken on-site inspections of 23 licensees with a trust licence. Most of the licensees were banks with a trust licence. Four of the inspections were in respect of licensees with a trust licence only.

To support the on-site examinations, the staff of CIMA have the benefit of an on-site procedures manual and a comprehensive "Trust and Trustee Reference Handbook". However, it is understood that the Handbook has been finalised only very recently and that the on-site inspections undertaken to date have proceeded on the basis of the procedures manual alone.

We consider that to be effective, more staff resources are needed for the on-site inspections programme.

The MAL, as amended, empowers CIMA to verify compliance with the Money Laundering Regulations 2000. CIMA has advised that this will be achieved through the on-site inspection programme.

13.4.4.4 ***Code of practice***

We consider the most appropriate method of meeting international standards in respect of knowing the identity of the settlor, beneficiaries, protector and custodian is through the regulation and supervision of the service provider.

The Cayman Islands Bankers Association has issued a Code of Best Practice which provides practical guidance on countering money laundering to those providing banking and trust company services. It complements the Code of Practice issued by the Governor in Council pursuant to Section 20 of the Proceeds of Criminal Conduct Law (1999 Revision). The Code of Practice covers, *inter alia*:

- Know your customer identification requirements, including the name and address of any donor of assets onto the trust or entity owned by the trust;
- Internal controls;
- Staff training;
- Retention of Records;
- Investment transactions; and
- Recognition and reports of suspicious transactions.

Trust business carried on by a licensee under the Banks and Trust Companies Law is now covered by the Money Laundering Regulations 2000 which cover the above except investment transactions. The Code of Best Practice requires that, at least annually, a report on anti-money laundering controls and compliance with procedures is prepared by internal auditors, the compliance officer or senior management as appropriate, and is submitted to the Board of Directors.

13.4.4.5 ***Enforcement of regulations***

We consider that CIMA should have the power to enforce the code of conduct.

In addition to its current powers, CIMA has the ability to "police the perimeter" and conduct investigation of persons suspected of undertaking licensable activities without authorisation.

Breach of the Money Laundering Regulations should be express grounds for regulatory sanctions, including revocation of a licence.

13.4.5 **Beneficial Ownership**

The terms of reference require us to ascertain the means available to regulators and law enforcement agencies to obtain details of the beneficial ownership of trust assets. We consider that the trust service provider should primarily be concerned with the source of the assets settled into trust. This will require the trust service provider to carry out due diligence to verify

the identity of the settlor, protector, custodian and any co-trustees. The trust service provider should keep in the Cayman Islands the following:

- a copy of the trust deed and any memorandum of wishes;
- details of the settlor and the source of all assets settled into the trust;
- the identity of the protector and any custodians and co-trustees;
- the identity of any known beneficiaries;
- minutes of all decisions taken by the trustees; and
- trust accounts or, at the very least, records which would enable trust accounts to be drawn up.

The above will then be available to law enforcement agencies and the regulator in the event of a criminal investigation taking place.

Whilst the Cayman Islands Bankers' Association Code of Best Practice covers a number of the above this does not extend to non-associated members and has very limited sanction powers.

However, mandatory "know your customer" and record keeping requirements under the Money Laundering Regulations 2000 deal with many of the matters noted above. The Cayman Islands should consider supplementing these by formal regulatory requirements as necessary.

13.4.6 **Insurance**

There is no requirement for licensed trust companies to maintain insurance cover against risks such as negligence, employee dishonesty, etc. We recommend that the legislation is amended to provide for this.

We welcome your comments on this site.

Prepared 27 October 2000

14 International co-operation

14.1 Introduction

A number of international standards are in place concerning the provision of co-operation between law enforcement and regulatory authorities. These include those established by international regulatory bodies such as IOSCO, IAIS and Basel, the relevant FATF/CFATF Recommendations, the "Ten Key Principles for International Financial Information Exchange" recommended by the G7 Finance Ministers in May 1998 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. These, together with good practice standards, are referred to in the Guidance Notes. We were not asked to consider international co-operation relating to purely fiscal matters, but we have considered whether the legislation permits co-operation on criminal tax matters.

The principal international standards and good practice standards set out in the TOR and the Guidance Notes are that:

- there are effective gateways in place through which an OT regulator can disclose confidential information obtainable from licensed bodies, including client information, to foreign regulatory authorities;
- the OT regulator is able, through the imposition of conditions, to require that confidential information it discloses to a foreign regulatory authority is not onward disclosed by the foreign regulatory authority without the consent of the OT regulator;
- an OT regulator is able to safeguard the confidentiality of information disclosed to it by a foreign law enforcement or regulatory authority;
- where necessary, MOUs between an OT regulator and foreign regulatory authorities are in place and that MOUs should contain provisions for safeguarding the confidentiality of information provided;
- the law enforcement authority in an OT has a full range of powers to provide mutual legal assistance to foreign law enforcement authorities, including the obtaining of evidence and the provision of assistance at the investigation stage;
- co-operation between law enforcement authorities should cover all financial crimes (including, for example, fraud, insider trading and market manipulation) and not just drugs related offences or money laundering;
- it should be possible for co-operation to be provided even if the activity under investigation takes place and/or is not a criminal offence in the OT;
- international co-operation should extend to tracing, freezing and confiscating proceeds of crime on behalf of overseas authorities. This should be on an "all crimes" basis (including all financial crimes), as envisaged by the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990;
- no assets should be immune from seizure by virtue of OT laws or through asset protection trusts or flee clauses in trusts;
- law enforcement and regulatory authorities should be able to co-operate effectively with each other both domestically and with their counterparts abroad;
- OT regulators can, in the course of their normal duties, obtain information relating to the supervision of licensees which can be disclosed to foreign regulatory authorities through the statutory gateways;
- OT regulators have powers at least equivalent to those contained in the Model "Compulsory Powers Ordinance" annexed to the Guidance Notes to compel the production of information, at the request of foreign regulatory authorities for their own regulatory purposes, from both regulated and unregulated bodies and persons; and
- adequate resources, including legal advice, are available to OT regulatory and law enforcement authorities for the

purposes of international co-operation.

The TOR for this review require us to consider whether the legislation and systems and procedures in place in the Cayman Islands for international co-operation conform to the above international and good practice standards.

Areas for development and action are contained in the issues and recommendations section below.

14.2 Confidentiality

14.2.1 Introduction

Regulators are usually subject to a duty of confidentiality which may be imposed:

- under a general statute which preserves the confidentiality of information with respect to business which is of a professional nature;
- in legislation which creates or governs the regulator;
- in legislation which provides for the regulation of particular financial services activities; and/or
- under common law.

It is appropriate, and in accordance with international standards, for restrictions to be placed upon the disclosure of confidential information by a regulator. However, in order for a regulator to co-operate effectively with foreign regulatory and law enforcement authorities, there must be gateways through which he can pass confidential information.

14.2.2 Relevant Cayman Islands legislation

The preservation of confidential information in the Cayman Islands is achieved primarily through the Confidential Relationships (Preservation) Law (1995 Revision) ("CRPL") and by the insertion of confidentiality provisions in the MAL.

There are statutory provisions which enable the disclosure of confidential information to law enforcement authorities in and outside the Cayman Islands and to foreign regulatory authorities. These are contained in both the CRPL and the MAL. In addition, other statutory and non-statutory practices and procedures are available to CIMA and the Royal Cayman Islands Police ("RCIP").

The following legislation contains provisions relating to the preservation of confidentiality and/or to international co-operation generally:

- the CRPL;
- the MAL, as amended in July 2000 by the Monetary Authority (Amendment) (International Co-operation) Law 2000 ("MAICL");
- the Mutual Legal Assistance (United States of America) Law, 1986 ("MLAT Law");
- the Misuse of Drugs Law (2000 Revision);
- the Misuse of Drugs (International Co-operation) Law (2000 Revision) ("MODICL");
- the Evidence (Proceedings in Other Jurisdictions) (Cayman Islands) Order 1978 ("EPOJ"); and
- the Proceeds of Criminal Conduct Law 1996 ("PCCL") and the Money Laundering Regulations 2000 made thereunder.

This legislation is covered below and, where relevant, in the section on Money Laundering.

14.2.3 CRPL

The Confidential Relationships (Preservation) Law codifies the English common law duty of confidentiality owed by a bank to its customer, extends the duty to other professional relationships and criminalizes a breach of that duty unless disclosure occurs under the CRPL's gateway provisions. CIMA and its officers and employees are subject to the CRPL.

Subject to certain exceptions, a person who divulges or attempts to divulge confidential information contrary to the CRPL commits an offence.

14.3 Co-operation between regulatory authorities

14.3.1 Legislative gateways - MAL

Section 30(2) of the MAL as amended by the MAICL, enables CIMA to compulsorily obtain information that it reasonably requires for its regulatory functions from licensees, persons connected with licensees and other persons who have relevant information. There is no restriction on the information that may be obtained by CIMA, which may therefore include client information.

Section 42 of the MAL provides that a director, officer, employee, agent or adviser of CIMA commits an offence if he discloses any information acquired in the course of his duties or in the exercise of CIMA's functions relating to:

- the affairs of CIMA;
- any application made to CIMA or the Governor in Council under the regulatory laws;
- the affairs of a licensee; or
- the affairs of a customer, client, or policyholder of, or a company or mutual fund managed by a licensee.

The principal gateway enabling international regulatory co-operation is contained in section 42(3) and (4) of the MAL, which was extended with the enactment of the MAICL.

Section 42(3), as amended, provides that CIMA may disclose to an overseas regulatory authority information necessary to enable that authority to exercise regulatory functions including the conduct of civil or administrative investigations and proceedings to enforce laws, regulations and rules administered by that authority. For these purposes, an overseas regulatory authority is defined as an overseas authority that exercises functions corresponding to those exercised by CIMA or such additional functions as may be specified in regulations made under the MAL. At the date of this report, no additional functions had been specified.

Subsection (3) is subject to subsection (4) which provides that nothing in the former authorises a disclosure by CIMA to an overseas regulatory authority unless CIMA is satisfied that the authority is subject to adequate legal restrictions on further disclosure, or the authority provides a non-disclosure undertaking to CIMA, and CIMA is satisfied:

- that the information is required for the purpose of the authority's regulatory functions; and
- that information provided following the exercise of its powers under subsection (3) will not be used in criminal proceedings against the person providing the information, other than proceedings for failure to comply with section 30 or an offence of perjury.

The companies legislation does not give the Registrar the ability to share information with overseas regulatory authorities. However, the MAL now empowers CIMA to obtain information from any persons reasonably believed to have information relevant to a CIMA enquiry.

14.3.2 Compulsory Powers

The Model Compulsory Powers Ordinance was developed by the UK and discussed with the OTs at a number of Attorney-Generals' Conferences. It is designed to provide OT regulators with powers to compel the production of information from both regulated and unregulated individuals and entities in order to satisfy a request for assistance made by a foreign regulator. As regulatory requests are civil rather than criminal, they cannot generally be made under legislation which enables the provision of assistance in criminal matters. Such powers are envisaged by IOSCO and represent good practice.

With the enactment of the MAICL, the provisions of the Model Compulsory Powers Ordinance have been substantially introduced in the Cayman Islands.

Section 30 of the MAL enables CIMA, on receiving a request from an overseas regulatory authority, to obtain specified information or information of a specified description that is relevant to inquiries to which the request relates, from licensees, persons connected with the licensee, and persons reasonably believed to have information relevant to enquiries to which the request relates. CIMA can also apply to the court to have a person examined on oath.

These powers are subject to legal privilege as defined in the MAL, which definition is coextensive with the provisions of the UK Drug Trafficking Act 1994, and protection against criminal prosecution for the person providing the information. A person who fails to comply without reasonable cause commits an offence under section 30(6) of the MAL.

14.3.3 **Memoranda of understanding ("MOU")**

To date CIMA has entered into one MOU, relating to banking supervision. This is with the Banco Central do Brazil ("BCB"). The MOU is primarily intended to enable BCB to undertake consolidated supervision of banks with a licence under the Cayman Islands' Banks and Trust Companies Law of which BCB is the home supervisor. The MOU specifically prohibits BCB from having access to any client information. This is, however, inconsistent with the Basel paper on "Cross-Border Banking" which provides that a home country supervisor should be able to gain access to information on individual clients and accounts under certain circumstances. However, at the time the MOU was agreed, we are advised that this presented no major issue for the BCB; we are further advised that during an on-site inspection by the BCB in August 2000, the inspection of client files to the extent necessary was performed by CIMA, to the satisfaction of the BCB.

CIMA is considering entering into Memoranda of Understanding with other regulatory authorities which will provide for access to client information for regulatory purposes, in accordance with the MAICL. The Cayman Islands Government has decided, however, that before proceeding with other MOUs it will develop a model MOU which, with necessary modifications could apply in all cases. A model MOU has been developed by CIMA and is currently under consideration by the Governor in Council.

14.3.4 **Confidentiality of information received from foreign regulators**

There is no provision that specifically requires CIMA to keep information that it receives from other regulators confidential. However, if the information relates to the affairs of CIMA, the affairs of a licensee or to the affairs of a customer, client or policy holder of or a company or mutual fund managed by a licensee, the information will be protected by section 42(1) of the MAL. The Cayman Islands Government considers that information relating to the affairs of CIMA covers information received from foreign regulators, particularly given to the MAICL's addition to CIMA's functions of the provision of assistance to overseas regulatory authorities.

Confidentiality may also be protected under the CRPL.

14.4 **Co-operation between law enforcement authorities**

14.4.1 **Legislation**

14.4.1.1 ***MLAT Law***

The MLAT Law gives effect in the Cayman Islands to the Mutual Legal Assistance Treaty agreed between the UK, on behalf of the Cayman Islands, and the USA in 1986 ("the Treaty"). The objective of the MLAT Treaty is to enable the provision of mutual legal assistance between the USA and the Cayman Islands for the investigation, prosecution and suppression of criminal offences. Virtually identical legislation is in place in the other Caribbean Overseas Territories.

For the purposes of the Treaty, a criminal offence is either conduct which satisfies the dual criminality test, ie it is conduct which is punishable by imprisonment of more than one year in both the Cayman Islands and the USA, or it is one of a number of specific listed offences which include insider trading and fraudulent securities practices.

Article 1 of the Treaty defines the scope of assistance to be provided. The Article states that mutual assistance is to be provided for the investigation, prosecution and suppression of criminal offences covered by the Treaty. With the exception of certain civil and administrative proceedings relating to narcotics, the Treaty does not extend to civil matters.

The Treaty can be used both for the obtaining of information and evidence and for search and seizure. However, information or evidence obtained cannot be used for purposes other than those stated in the request without the approval of the party to whom the request is made.

A person who divulges confidential information in conformity with a request is given immunity from any action for breach of confidentiality.

The Authority under the MLAT Law in the Cayman Islands is the Chief Justice. The US Authority is the Department of Justice.

14.4.1.2 ***MODICL***

The MODICL ratifies and enforces by law in the Cayman Islands, the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances. The legislation is restricted to drugs related offences specified in Article 3(1) of the Vienna Convention.

The Central Authority for the receipt of requests under the MODICL is the Attorney-General.

The MODICL contains "ship riding" powers.

14.4.1.3 ***EPOJ***

The EPOJ enables the Grand Court to provide assistance to a court or tribunal in another jurisdiction to obtain evidence for criminal (and civil) proceedings.

The Court may, in relation to criminal proceedings, make an Order for the examination of witnesses, either orally or in writing, or for the production of documents. This Order may only be used when proceedings have already been instigated. It is not, therefore, available at the investigation stage***.***

14.4.1.4 ***CRPL***

Section 3(2)(b)(iii) of the CRPL can also be used to effect co-operation between law enforcement agencies.

The subsection provides that the CRPL has no application to the seeking, divulging or obtaining of confidential information by or to a constable of the rank of Inspector or above, specifically authorised by the Governor in Council in that behalf, investigating an offence committed or alleged to have been committed outside the Cayman Islands which offence, if committed in the Cayman Islands, would be an offence.

This provision is relied upon by the Cayman Islands Government as providing a gateway which enables the RCIP to give assistance to other law enforcement agencies and it is frequently used.

Section 4(1) of the CRPL provides that where a person intends or is required to give in evidence in, or in connection with, any proceedings being tried, inquired into or determined by a Court (whether inside or outside the Cayman Islands), any confidential information, he must obtain the authorisation of the Court. This section applies even where the Court has made an Order under the EPOJ.

14.4.1.5 ***MODL and PCCL***

The MODL and the PCCL provide for the enforcement of external confiscation orders.

14.4.2 **Provision of co-operation**

The Chief Justice keeps a log of all MLAT requests received and made by him. There have been 182 incoming requests under the MLAT Law since its inception. We were advised by the Chief Justice that there have also been many supplemental requests and that assistance has been provided in well over 90% of all cases. We were advised that the average turnaround time for requests is 6 weeks. This was supported by our examination of sample files.

14.5 **Requests to other jurisdictions for assistance in criminal matters**

A total of 8 outgoing requests have been made to the US under the MLAT Law. In all cases, assistance has been provided.

14.6 **Co-operation between regulatory and law enforcement authorities**

The MAICL enables CIMA to disclose matters to the RCIP with a view to the institution of, or for the purpose of, criminal proceedings.

There is no provision, as envisaged by the INIS Principles, under which CIMA is formally notified of findings of investigation into fiscal, money laundering and similar activities.

14.7 **Co-operation on fiscal matters**

14.7.1 **MLAT Law and Treaty**

MLAT assistance on tax matters is limited at present only to tax offences arising from the proceeds of other crimes covered by the Treaty or wilfully or dishonestly failing to make a report to tax authorities in respect of, or pay tax due on, any such lawful proceeds. The selling of fraudulent tax shelter schemes is also covered under Art 19(3)(d).

14.7.2 Other Laws

Co-operation on fiscal matters is very limited. There is no definition of "criminal proceedings" in the EPOJ, although section 5(3) provides that the section does not apply to criminal proceedings of a political nature. There therefore appears to be no "dual criminality" test under the EPOJ and, subject to judicial pronouncement, the EPOJ may, therefore, apply to fiscal offences.

However, as the EPOJ is not available unless proceedings have been instituted, it does not enable assistance to be provided at the investigation stage, except for civil proceedings.

Apart from the EPOJ, and with the exceptions referred to in the description of the MLAT Law above, there is currently no other means of co-operation on fiscal matters.

14.8 Intelligence networks

The Cayman Islands participate in the Overseas Territories Regional Criminal Intelligence System ("OTRCIS"). This system, which is operated out of Miami, is aimed to assist the UK Caribbean Overseas Territories law enforcement personnel to combat local criminality occurring in each individual Territory, as well as the threat posed by drug trafficking and organised crime including money laundering. OTRCIS provides a secure database on information relating to criminal and suspected criminal activity in the Overseas Territories.

14.9 Support

14.9.1 Resources

Legal support on matters of co-operation, both criminal and regulatory, is provided by the Attorney-General's Chambers. CIMA also has its own in-house legal counsel.

14.9.2 Egmont Group of Financial Intelligence Units

The Cayman Islands is not a member of the Egmont Group but it has observer status, and it intends to proceed to full membership.

14.9.3 White Collar Criminal Investigation Team

Additional support is available via the White Collar Criminal Investigation Team ("WCCIT"). This is a joint UK/FBI team operating out of the FBI offices in Miami. Currently two UK police officers are seconded to the team. These officers are also sworn in as police officers in each of the Caribbean Overseas Territories.

The role of WCCIT is to undertake and assist in the investigation of white collar crimes involving the US, the UK and the OTs in the Caribbean. WCCIT does not have authority to initiate investigations in respect of drugs and drug-related offences. There are resources available to assist the OTs with drug-trafficking investigations through the drugs liaison network in the region. There is also a UK appointed Drugs Law Enforcement Adviser for the OTs available to assist with OT-related drugs matters.

14.10 Issues and recommendations

14.10.1 Introduction

With the recent enactment of amending legislation, including the MAICL, the Cayman Islands have the legislative framework necessary to provide effective international co-operation in respect of regulatory matters. The Cayman Islands is also able to provide substantial international co-operation in criminal matters, although some improvements are required especially with regard to the provision of assistance at the investigatory stage in respect of criminal matters.

Our recommendations are set out in the paragraphs below.

14.10.2 Co-operation between regulators

14.10.2.1 ***Scope of existing gateways***

The Guidance Notes require that the statutory gateways should extend to the passing of client information to foreign regulatory authorities. Although this was not previously possible, the recent legislation has removed the prohibitions on the passing by CIMA of client information to foreign regulatory authorities.

It is acceptable for the disclosure of client information to be restricted to cases of established regulatory need and to be subject to strict conditions on non-disclosure.

We consider that the MAL, as amended, complies with international standards concerning regulatory gateways for co-operation with overseas regulatory authorities.

Currently there is no regulation of securities and investments other than under the MFL and through the CSX regime. Therefore the powers of co-operation are currently limited. This problem could be addressed by the specification of overseas securities and investment regulators in regulations made under the MAICL.

14.10.2.2 ***Memoranda of understanding***

The Guidance Notes state that MOUs should be put in place where deemed necessary. As indicated, the Cayman Islands does have one MOU, although we do not consider that it complies with international standards as it restricts the information that may be disclosed.

We consider that the concluding of MOUs is a regulatory matter and that the decision whether to enter an MOU should be exclusively one for CIMA.

We recommend that:

- The model MOU should be finished. This model should be in accordance with the principles set out by IOSCO and Basel.
- The decision on whether to enter into an MOU should be made by CIMA rather than the Governor in Council.

14.10.2.3 ***Compulsory powers***

As stated above, the provisions of the Model Compulsory Powers Ordinance have effectively been enacted through the MAICL. We note that there are slight differences between the MAICL and the Model Ordinance but, except as provided below, we do not consider that these are material.

We note that CIMA is not entitled to information or documentation that is protected by legal professional privilege. By virtue of section 30(5e) of the MAL, professional legal privilege extends to information and documentation communicated or given to a professional legal advisor in connection with the seeking or giving of legal advice or in contemplation of or in connection with legal proceedings. Information communicated or given with a view to furthering a criminal purpose is not privileged, We consider that the above definition is rather more extensive than legal privilege under English common law and that, to that extent, the new provisions do not provide equivalence to the Model Ordinance. However, the MAL definition is the same as that in the UK Drug Trafficking Act 1994.

Given the recent enactment of the MAICL, it is not possible to determine how the compulsory powers will operate in practice. We recommend, therefore, that the impact is carefully monitored to ensure that it provides the level of co-operation expected. Nevertheless we consider these changes as positive indications of the Cayman Island's commitment to international co-operation.

14.10.2.4 ***Confidentiality of information received***

We consider that there is a need for legislative provision covering the confidential treatment of information received from regulatory authorities in other jurisdictions. Whilst MAL will ensure confidentiality in respect of licensees and their clients, we consider that, in order to ensure certainty, there is a need for legislative provision covering the confidential treatment of information received from regulatory authorities in other jurisdictions express legislative provision should be made. In order to facilitate international co-operation and meet international standards specific provision for the confidentiality of information received from other regulators should be contained in statute.

We therefore recommend that the MAL should be amended to provide for the confidential treatment of confidential information passed to CIMA by overseas regulatory authorities.

Finally, whilst the contacts between CIMA and the police are good, in order to demonstrate compliance with IAIS guidelines there needs to be a formal communication process whereby the RCIP advise CIMA of the findings or investigations relating to fraud and money laundering.

14.10.3 **Co-operation between law enforcement authorities**

14.10.3.1 ***Introduction***

The Guidance Notes require that the law enforcement authorities in each OT have a full range of powers to provide mutual legal assistance to foreign law enforcement authorities. The Guidance Notes indicate that an OT will be able to satisfy this requirement if its legislation provides equivalence to the UK Criminal Justice (International Co-operation) Act 1990 ("the UK Act").

There is no single Law in the Cayman Islands that provides equivalence to the UK Act. The provisions covering co-operation between law enforcement authorities are contained in a number of different Laws. We have reviewed those Laws to ascertain whether, taken together, they provide equivalence to the UK Act.

14.10.3.2 ***MODICL***

We consider that the MODICL provides broad equivalence to the UK Act in respect of drug matters.

14.10.3.3 ***Other Laws***

The EPOJ permits the Grand Court to provide assistance after proceedings have been instituted. The EPOJ cannot be used at the investigation stage with respect to criminal matters.

As stated, the Cayman Islands relies upon the CRPL to enable assistance to be provided to foreign law enforcement authorities, particularly at the investigation stage. We note, however, that the exceptions to the CRPL are not enabling provisions. They do not specifically provide that a police inspector can provide assistance but simply state that the CRPL does not apply to such actions. It would not, therefore, permit information to be disclosed if it was confidential otherwise than by virtue of the CRPL.

Furthermore, as indicated, section 4(1) of the CRPL provides that where a person intends or is required to give any confidential information in evidence, or in connection with any proceeding being tried, inquired into or determined by a Court (whether inside or outside the Cayman Islands), he must obtain the authorisation of the Cayman Islands Court.

This section applies even where the Court has made an order under EPOJ. The effect of this is to set a double hurdle before an overseas law enforcement agency where it seeks to obtain confidential information by way of written or oral evidence under EPOJ. Having obtained the EPOJ Order, the person required to give evidence is then required to obtain an order under section 4 of the CRPL.

The rationale for this appears to be historic. We recommend that the double hurdle is removed.

We therefore recommend that specific statutory provision should be made enabling assistance to be given to foreign law enforcement authorities at the investigation stage in respect of criminal matters.

14.10.3.4 ***MLAT***

Both our discussions with the US Department of Justice ("DOJ") and the recent FATF Report on the Cayman Islands indicate that the DOJ are completely satisfied with the operation of the Treaty in practice.

The US Securities and Exchange Commission ("SEC") has expressed concern as to the use of the Treaty as it has been unable to utilise it on a number of occasions. The main problems appear to be:

- the SEC (through the DOJ) has been refused assistance on the grounds that its proceedings are civil or administrative in nature and therefore outside the scope of the MLAT or because they are not the criminal prosecuting authority; and
- information has been passed by the MLAT Authority to the DOJ, but on condition that the information is not onward disclosed by the DOJ (whether to the SEC or anyone else) without the consent of the Authority. Where the Authority considered that the SEC was pursuing civil or regulatory proceedings, which upon the advice of US

Counsel the Cayman Islands consider to be outside the MLAT, consent to disclose information to the SEC has been refused unless it is information already publicly available.

We understand that the Cayman Islands Government and the DOJ had commenced negotiating an extension to the Treaty that would have enabled the Cayman Islands, through the Chief Justice, to provide information on relevant securities matters to the SEC (through the DOJ) even where the SEC is acting in a civil or administrative role.

We note that, this is now unnecessary as, with the enactment of the MAICL, the legislative framework necessary to enable CIMA to provide regulatory assistance to the SEC has been put in place. This will allow for assistance to be provided to the SEC in the early stages of an investigation, before it is clear whether the matter is a civil or criminal one. Where the latter, this would proceed via the MLAT; otherwise assistance will be continued under the MAICL. We recognise the Cayman Islands Government's work to extend assistance to the SEC as a positive move.

14.10.3.5 ***Restrictions on the ability to co-operate in relation to fiscal offences***

Given the requirement for dual criminality in relation to the exchange of information under the MLAT, it may not be possible to provide co-operation in respect of conduct which may constitute a financial services criminal offence in the USA but which does not constitute a criminal offence in the Cayman Islands. However, a number of matters which are not offences in the Cayman Islands is specified in the Treaty as noted in 14.7.1.

Furthermore, it is understood that the Cayman Islands has given a commitment to the OECD to address criminal tax matters by exchange of information arrangements effective for the first tax year after December 2003.

14.10.3.6 ***Tracing, freezing and confiscation of proceeds of crime***

Both the MODL and the PCCL provide for the enforcement of overseas forfeiture or confiscation orders.

The PCCL depends upon dual criminality and therefore does not extend to conduct that may be a financial crime in a foreign jurisdiction but which is not an indictable offence in the Cayman Islands (for example, insider trading and market manipulation). Therefore, the provisions that permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

We recommend that compliance is achieved by extending the range of financial crimes.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or flee clauses. For the reasons set out in the section of this Report on Trusts, we do not consider asset protection trusts to be significant in the Cayman Islands. Please see our recommendations concerning flee clauses in the section on Trusts.

14.10.4 **Transparency in co-operation**

Discussions within and outside the Cayman Islands indicate that the potential gateways for co-operation are not always well understood by those requesting assistance. Failure to utilise the appropriate gateway can lead to delay and the impression of a lack of co-operation.

To address this issue, the Cayman Islands Government should consider producing and publishing (possibly via the World Wide Web) guidance notes for foreign regulatory and law enforcement authorities detailing the types of co-operation available and the appropriate procedures for seeking the different types of co-operation.

14.10.5 **WCCIT**

To facilitate the full assistance of WCCIT in relation to money laundering offences, we recommend that the current exclusion of drug-related matters from its scope is removed.

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15 Anti-money laundering

15.1 Introduction

A number of international standards are in place setting legislative and practical measures that should be taken to combat money laundering. These are contained principally in the FATF 40 Recommendations and the CFATF 19 Recommendations, the Vienna Convention and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. We are asked to consider to what extent the OTs apply the standards set out in these documents together with those contained in the EC Money Laundering Directive (June 1991).

Our report falls into two parts. The first covers the legislation, regulations and guidelines in place. The second covers the implementation of the legislation, regulations and guidelines, especially as regards the reporting, handling and investigation of suspicious transaction reports.

15.2 Factual assessment

15.2.1 Legislation

15.2.1.1 *Introduction*

The Cayman Islands has three pieces of primary legislation dealing with money laundering:

- the Misuse of Drugs Law (2000 Revision) ("MODL");
- the Misuse of Drugs (International Co-operation) Law 1997 ("MODICL"); and
- the Proceeds of Criminal Conduct Law 1996 ("PCCL"), as amended by the PCCL (Amendment) (Money Laundering Regulations) Law 2000;
- In August 2000 the Money Laundering Regulations were made under the PCCL 2000.

15.2.1.2 *MODL*

The MODL, in conjunction with the MODICL, was enacted to implement the Vienna Convention in the Cayman Islands. The following money laundering offences were created by the MODL:

- assisting drug trafficking (Section 47);
- concealing or transferring the proceeds of drug trafficking (Section 48); and
- prejudicing an investigation (section 44(9)).

The *mens rea* for the offence of assisting another to retain the benefit of drug trafficking is "knowing or believing" that the other person carries on or has carried on drug trafficking or has received any payment or reward in connection with drug trafficking.

The *mens rea* for the offence of concealing or transferring the proceeds of drug trafficking is "knowing or having reasonable grounds to believe that" property is or represents another person's proceeds of drug trafficking.

The offence provisions apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit offences under the MODL.

15.2.1.3 *Other provisions of the MODL*

Section 26 of the MODL makes provision for the seizure of cash which is being imported into or exported from the Cayman Islands and which is or is suspected of being the proceeds of drug trafficking.

Section 31 of the MODL contains powers of confiscation and restraint by the courts. The RCIP also have power under the Act to seize realisable property and prevent its removal from the jurisdiction.

Sections 49 and 50 establish procedures for registering at Court and enforcement of foreign confiscation orders made by the court of a country designated under the Misuse of Drugs (Designated Countries and Territories) Order 1996.

The MODL also provides for the recovery of the proceeds of drug trafficking.

As its name suggests, the MODL is concerned with drug trafficking only and its money laundering provisions are therefore limited to those dealing in the proceeds of the underlying (or "predicate") offence of drug trafficking.

15.2.1.4 ***The Misuse of Drugs (International Co-operation) Law ("MODICL")***

The MODICL enables the Cayman Islands to co-operate with other countries in drug-related criminal proceedings and investigations and, in so doing, gives effect to the mutual legal assistance provisions of the Vienna Convention. The MODICL is discussed further in the section of this Report on international co-operation.

15.2.1.5 ***Proceeds of Criminal Conduct Law ("PCCL")***

The Cayman Islands introduced "all crimes" anti-money laundering legislation through the PCCL, which was brought into force on 20 September 1996. The money laundering provisions in the PCCL apply to "criminal conduct" which is defined as an indictable offence or conduct taking place outside the jurisdiction which would constitute such an offence if it had occurred in the Cayman Islands. This concept is known as "dual criminality". Drug trafficking offences are specifically excluded as they are covered under the MODL.

The following money laundering offences were created by the PCCL:

- assisting another to retain the benefit of criminal conduct (Section 21);
- acquisition, possession or use of property representing the proceeds of criminal conduct (Section 22);
- concealing or transferring the proceeds of criminal conduct (Section 23); and
- tipping off (Section 24).

Section 25A of the PCCL provides for the compulsory disclosure to the Reporting Authority of a suspicion that a person is engaged in money laundering, including drug money laundering, based on information acquired in the course of business. This does not extend to information acquired in privileged circumstances. Privilege is defined in identical terms as in the amended MAL. This is discussed more fully in the Section of this Report on International Co-operation.

The *mens rea* for the above offences is as follows:

- the offence of assisting: "actual knowledge or suspicion" that the person assisted is or has been engaged in or benefited from criminal conduct;
- the offence of acquisition, possession or use: "actual knowledge" that the property is another's proceeds of criminal conduct; and
- the offence of concealing or transferring: "knowing or having reasonable grounds for suspecting" that the property is another's proceeds of criminal conduct.

Sections 21 and 22 of the PCCL provide for reporting suspicious transactions to a Reporting Authority appointed under Section 20. Both sections provide that if a person makes a disclosure to the Reporting Authority:

- that disclosure shall not be treated as a breach of any duty of confidentiality imposed by any enactment or give rise to any civil liability; and
- provided the disclosure is made in accordance with the section, he does not commit an offence in contravention of the section.

Provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

Sections 5 to 8 of the PCCL provide for confiscation orders and Sections 9 and 10 provide for making restraint orders.

Section 26 of the PCCL gives police officers a power of arrest.

Sections 27 and 28 of the PCCL contain provisions that enable police officers to make applications to Court for orders requiring information to be made available and also for search and seizure orders. Section 27 also contains provisions which make it an offence to disclose the fact that an order has been made under the Section if such disclosure is likely to prejudice the investigation.

Part III provides for enforcing external orders. To date, only the UK and the US have been designated for the purposes of this Part.

15.2.2 **Regulations**

The MLRs were gazetted on 7 August 2000. They are based on the UK Money Laundering Regulations 1993.

The MLRs apply to any entity or person carrying on relevant financial business in the Cayman Islands. Relevant financial business is defined as:

- Banking and trust business carried on by a licensee;
- Acceptance of deposits by a building society;
- Business carried on by a co-operative society;
- Insurance business;
- Mutual fund business;
- Company management business; and
- Other financial business set out in schedule 2 including, *inter alia*, money transmission services, CSX listing agent and broker member services, services relating to the sale, purchase or mortgage of land.

Every person subject to the MLRs is required to:

- maintain client identification procedures;
- maintain record-keeping procedures in accordance with the MLRs;
- maintain procedures of internal controls for the purposes of forestalling and preventing money laundering, including the designation of a money laundering reporting officer; and
- take appropriate measures for the purposes of staff familiarisation and training.

There is an exemption from the required client identification procedures in respect of introduced business where the introducer is regulated by an overseas regulatory authority and is based in, incorporated in or formed under the law of a jurisdiction specified in schedule 3 to the MLRs. Furthermore, the MLRs establish a threshold of CI$15,000 for the determination of when client verification evidence is required and there is provision for linked transactions.

In addition, the MLRs cover the duty of CIMA and the Minister to report suspected money laundering transactions.

As is the case with the UK Money Laundering Regulations 1993, the transitional provisions do not require the identification of customers existing at the date that the MLRs came into force.

A person who undertakes relevant financial business without having the required client identification, record keeping, internal control and staff training procedures in place commits an offence.

15.2.3 **Guidance Notes**

15.2.3.1 ***Money Laundering Code of Practice ("the Code of Practice")***

The Code of Practice was issued by the Governor in Council under Section 20 of the PCCL on 28 March 2000. The Code of

Practice reflects joint proposals agreed by the private sector and the government.

Paragraph 7 of the Code of Practice states that the provisions of the Code are intended to be advisory and that a failure to comply with it does not mean that any offence has been committed. However, the Code now has now been partially superseded by the mandatory MLRs, together with which the Code must now be read.

The provisions of the Code of Practice include the following:

- maintaining procedures in respect of client identification, record keeping and internal reporting procedures;
- internal controls to assist in preventing money laundering;
- making staff aware of the requirements of the Code of Practice and the firms' procedures; and
- staff training.

15.2.3.2 ***Other guidance/codes***

The Company Managers' Association, the Bankers' Association and the Mutual Fund Administrators' Association have produced voluntary Codes of Conduct on Money Laundering for their members. These are intended to supplement the Code of Practice.

15.2.4 **Fiscal offences**

Fiscal offences are not predicate offences under the PCCL, therefore co-operation cannot be provided. However, where other offences caught by the PCCL, such as fraud, have a fiscal element co-operation can be provided.

15.2.5 **Anti-money laundering - framework, system and procedures**

15.2.5.1 ***Reporting Authority***

Section 20(2) of the PCCL provides for the Governor in Council to appoint a Reporting Authority. At present the Reporting Authority comprises the Commissioner of Police, the head of the RCIP Financial Intelligence Unit ("FIU") and the head of the commercial crime branch.

Reports of suspicious transactions ("SARs") are required by law to be made to the Reporting Authority but are in fact made directly to the FIU. Reports under the MODL are also made to the Reporting Authority through the FIU.

The following reports have been made:

1997	151
1998	139
1999	211
2000 (to end of March)	35
Total	536

The majority of reports are submitted by banks.

Feedback is given to the person who made the report either in writing or verbally.

Section 21 of the PCCL allows reports to be passed to foreign authorities with the consent of the Attorney-General. Disclosure is permitted where the foreign authority is investigating an offence committed in the Cayman Islands or what would be an offence if it was committed in the Cayman Islands. Disclosure can cover:

- reporting the possible commission of an offence;
- initiating a criminal investigation;
- assisting a criminal investigation; or
- giving effect to the provisions of the PCCL.

The Attorney-General's Chambers in conjunction with CIMA and the Portfolio of Finance & Economic Development are responsible for developing and implementing Cayman Islands' anti-money laundering infrastructure.

15.2.5.2 ***FIU***

Apart from receiving all SARs, the FIU is the repository for "financial intelligence", undertakes all "international" enquiries, deals with international requests for assistance (from the Chief Justice and the Attorney-General's Chambers) and routinely carries out vetting for CIMA. The FIU comprises six police officers headed by a Detective Chief Inspector. The FIU also has the services of a forensic accountant on a part-time basis. Given the workload outlined above, we consider the staffing resources to be insufficient. There is no formal training programme, training being "on the job". We do not consider this to be adequate.

The FIU is a stand-alone function within the RCIP and is answerable directly to the Commissioner of Police. Its database of information is not available to other members of the force. This is felt by the FIU to be vital to maintain the security of the information held. This approach is not uncommon and restricting access to the database exists in other jurisdictions, including the UK.

15.2.5.3 ***Chief Justice and Attorney-General's Chambers***

The Chief Justice is the MLAT Authority. Although he receives and deals with all requests himself, a copy of each is sent to the Attorney-General's Chambers. The Chief Justice keeps a log of all requests received.

The Attorney-General receives requests under the MODICL and is responsible for advising on any non-MLAT requests for assistance received by Government.

The Attorney-General's Chambers comprises twelve attorneys plus the Attorney-General himself. The Chambers is currently in the process of recruiting an additional two Crown Counsel. The Chambers has difficulty in keeping Caymanian Counsel as the salary levels in the private sector are much higher.

We have been advised that the Attorney-General has identified that to deal with current and projected money laundering prosecutions, specialist teams managed by case controllers are required. In addition, it is proposed that resources in the Legal Affairs Portfolio be pooled to form a Legal Resources Centre, to be appropriately housed, with the necessary IT and library facilities.

We have been advised that for the last 16 years a register has been kept of all incoming and outgoing matters including requests for legal assistance. This register is computerised and has search facilities so that any matter can be traced.

In addition to his involvement in anti-money laundering efforts, the Attorney-General is responsible for prosecutions and all legal work for Government and associated organisations.

15.2.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies is primarily done through participation in the CFATF and the Egmont Group (as observer) and by attending other conferences and workshops.

15.2.7 **Other measures to avoid money laundering**

There are no direct measures to detect or monitor cross-border transportation of cash and bearer instruments. Where cash is discovered, however, and it is suspected that it is the proceeds of drug trafficking, it is held and the person carrying it is questioned as to its source. It may also be forfeited by the Court if the Court is satisfied on the balance of probability that it directly or indirectly represents proceeds of drug trafficking or is intended for use in drug trafficking. Additionally under the Code of Practice, financial services providers are expected to monitor the physical movement of cash, bearer securities and wire transfers, although no formal measurement system is in place.

There are no requirements on the reporting of transactions above a certain value.

There is no measurement system in place recording the international flows of cash and bank transfers into or out of the Cayman Islands.

The Cayman Islands legislation does not distinguish between launderers who are public officials and others.

15.3 **Issues and recommendations**

15.3.1 **Introduction**

The Cayman Islands has introduced a number of significant legislative and regulatory provisions designed to bring it into compliance with international standards, including modern "all crimes" money laundering legislation. The legislation taken as a whole is extensive and contains much of the material and covers most of the issues that we would expect in a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of the Cayman Islands' commitment to prevent money laundering.

Some enhancements are required to the MODL and these are addressed below. Also, the Code of Practice now needs to be reviewed to ensure that it takes account of the Money Laundering Regulations 2000.

Additionally, the recommendations contained in the other sections of this Report relating to changes in the regulatory structure should be implemented. We are pleased to note that regulatory on-site visits will also cover compliance with the MLRs.

15.3.2 **Legislation**

15.3.2.1 ***MODL***

As indicated above, the offences of concealing, transferring or acquiring the proceeds of another's drug trafficking are created in the MODL. However, the offences of possessing and using another's proceeds of drug trafficking are not provided for. In the circumstances, the Cayman Islands does not fully comply with FATF Recommendation 4 and does not give full effect to article 3 of the Vienna Convention. The Cayman Islands Government has advised us that the omission of these offences from the MODL was inadvertent and that amending legislation will be introduced to rectify the position.

The *mens rea* for the MODL offence of assisting another to retain the benefit of drug trafficking is "knowing or believing" that the person assisted, is carrying on or has carried on drug trafficking. CFATF Recommendation 4 requires jurisdictions to consider whether the *mens rea* for money laundering should be extended to cover a person who has "reasonable grounds to suspect" that the proceeds were derived from drug trafficking. We consider that this is appropriate and that the PCCL and the MODL should be amended accordingly.

The *mens rea* for the MODL offences of concealing or transferring or acquiring the proceeds of another's drug trafficking is 'knowing or having reasonable grounds to believe that the property represents the proceeds of another's drug trafficking which complies with international standards.

In order to fully comply with FATF recommendation 17, the MODL should provide for the offence of tipping off. Although the MODL creates the offence of prejudicing an investigation (section 44(9)), this is not equivalent to the offence of tipping off. In order for a person to commit the offence of prejudicing an investigation under the MODL, it is necessary for an order for production or access under section 44(2) to have been made or applied for or for a search warrant under section 45 to have been issued or applied for.

The offence of tipping off under the PCCL requires that a person knows or has reasonable grounds for suspecting that a money laundering investigation is being or is about to conducted or that a disclosure has been made to the Reporting Authority.

We recommend that the offence of prejudicing an investigation is extended to provide equivalence with the tipping off offence in the PCCL.

15.3.2.2 ***PCCL***

Part III provides for the enforcement of external orders. To date, only the UK and the US have been designated for the purposes of this Part. We consider that this extremely limited designation is not sufficient to bring the Cayman Islands into compliance with FATF Recommendation 38. We have been advised by the Attorney-General, however, that Executive Council has agreed that all jurisdictions that are members of the FATF should be designated and that this is in the process of being implemented.

As indicated, the *mens rea* for the offence of assisting is "actual knowledge" or "actual suspicion" and for the offence of acquisition is "actual knowledge". We recommend that the *mens rea* for each offence should extend to having "reasonable grounds to suspect" as envisaged by CFATF Recommendation 4. We consider that a similar amendment should be made to

the PCCL.

We note that the Cayman Islands does not distinguish between launderers who are public officials and others, as envisaged by CFATF Recommendation 5. Sentencing discretion should enable the judiciary to set higher penalties for public officials who commit money laundering offences. We are advised that the Chief Justice has stated that the comment regarding higher penalties for public officials is duly noted and can be appropriately taken into account by the judiciary as a matter of sentencing policy.

There is no requirement to report transactions above a certain value. Whilst such a system is envisaged by FATF Recommendation 23 and CFATF Recommendation 14, the Recommendations do not make such a provision mandatory. We consider that a decision upon whether such a reporting regime should be implemented is for the jurisdiction itself to take rather than an international standard.

15.3.3 **Money Laundering Regulations and Anti-Money Laundering Code of Practice**

We have examined the MLRs and consider that with the exception of the matter referred to below they will comply with FATF Requirements once appropriate guidance notes to support them are in place. As indicated, the Code of Practice has been partially superseded by the MLRs and we recommend that it is reviewed and amended as necessary to ensure full compatibility with the MLRs.

We consider that the exemption from the requirement to verify the identity of a client if the client was an existing client at the time that the MLRs were introduced is a weakness and not in accordance with good practice. It is possible that fictitiously named accounts or other relationships could have been established prior to the date the regulations came into effect and this exemption would permit their continued operation. Ongoing existing clients should also, therefore, be requested to verify their identify.

The Cayman Islands' government considers that the exemption for existing clients accords with universal practice, particularly in a criminal statute, and the relevant provision is co-extensive with that in the UK Money Laundering Regulations 1993. Further, unlike the UK, the Cayman Islands has mandatory suspicious activity reporting for all crimes which puts a continuing obligation to report suspicions on any client. Finally, section 67.4 of the Code of Practice requires that existing clients be kept under review, as "know your client" is a continuing process.

We have reviewed the Code of Practice and consider that it does not at present provide sufficient guidance on detecting suspicious transactions and, to that extent, it fails to fully comply with FATF Recommendation 28.

In our view, the provisions regarding internal reporting procedures and internal controls do not contain sufficient detail. However, we note that the Code is intended as a head code and we have been advised by the Government that the bankers and mutual fund administrators have already submitted proposed codes (which we have not seen) which will provide sector-specific guidance. We welcome this development and hope that our views are considered in the review.

15.3.4 **Reporting Authority/Financial Investigation Unit**

15.3.4.1 ***Reporting Authority***

At present, there is no forum for financial enforcement agencies to discuss policy or share raw intelligence. We therefore recommend that Customs should become involved with the Reporting Authority. Customs has set up its own financial investigations unit and, in our view, it would operate more effectively were it to more closely co-ordinate with the FIU.

The Caymans Islands have responded that representatives from Customs and CIMA have been included.

15.3.4.2 ***Financial Investigation Unit***

We consider that there is scope for the FIU to develop a system for sharing intelligence, on a limited basis if necessary, with Customs and other arms of the RCIP.

We consider that the FIU is under-resourced. Recruitment of officers with specialist skills and secretarial backup should be considered.

We consider that a more formal training programme should be established. We recommend that training should include exchange secondments with NCIS or other money laundering authorities.

15.3.4.3 ***The Attorney-General's Chambers***

Given the scope of work undertaken by the Attorney-General's Chambers, we concur with the Attorney-General that the staffing resources of the Attorney-General's Chambers are insufficient and that resources of the Chambers need to be increased.

15.3.5 **Monitoring of compliance by regulated institutions**

As indicated, following the recent amendment to the MAL, CIMA has the responsibility for monitoring compliance with the Money Laundering Regulations. We consider that this is a positive development. However, the lack of more extensive on-site inspection programmes for licensed institutions means that FATF Recommendation 26 and CFATF Recommendation 11 are not being fully complied with. Recommendations in relation to this are contained in the relevant sections dealing with each type of regulated activity.

15.3.6 **Business awareness**

On the basis of our discussions with representatives of the private sector, we consider that the level of business awareness is reasonably high.

15.3.7 **Other regulations**

The lack of a full regulatory system for company formation and corporate service providers (falling outside the Company Management Act) and of investment business may mean that persons who are not "fit and proper" can operate such a financial institution. This is not in compliance with FATF Recommendation 29.

15.3.8 **Cross-border flows of funds**

As indicated, there are no direct measures to detect or monitor the cross-border transportation of cash and bearer instruments.

Whilst such a detection system is envisaged by FATF Recommendation 22, the Recommendation does not make the provision mandatory. We consider that the implementation of such a system is an option, rather than an international standard.

Nevertheless, we recommend that the Cayman Islands should consider imposing a requirement upon its licensed banks and other relevant institutions to report cash flows to and from abroad, in accordance with FATF Recommendation 30 and CFATF Recommendation 15.

We welcome your comments on this site.

Prepared 27 October 2000

Appendix 1

PREAMBLE: REVIEW OF FINANCIAL REGULATION IN THE CARIBBEAN OVERSEAS TERRITORIES AND BERMUDA

The Overseas Territories' White Paper proposes establishing a renewed contract between the UK and the Overseas Territories (OTs). A modern and effective partnership should be built upon the foundations of responsibilities on both sides, coupled with the UK assisting the OTs where necessary, and the OTs exercising control over their own lives in a responsible way.

The UK is pledged to look after the OTs' interests internationally. This goes hand in hand with the OTs meeting accepted international standards, and playing a responsible role in the international community. In the area of offshore financial services, some of the OTs are significant players in their own right. The business conducted in offshore centres is often linked intrinsically with activities regulated in other countries, including the UK and our key international partners. The quality of regulation in the OTs has an indirect or direct effect on people, firms, and markets in other countries, as well as the international financial system.

The Terms of Reference provide for an indepth independent review by experts to assess progress made in the regulation of the offshore sector, and to make further recommendations on how to deal with outstanding issues. HMG circulated Guidance Notes to Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands which indicate accepted international standards and good practice in financial regulation. Following consultation with these OTS, the Guidance Notes and Terms of Reference for the review of financial regulation in the OTs have been revised.

2 September 1999

TERMS OF REFERENCE FOR THE REVIEW OF FINANCIAL REGULATION IN ANGUILLA, BERMUDA, BRITISH VIRGIN ISLANDS, CAYMAN ISLANDS, MONTSERRAT AND TURKS AND CAICOS ISLANDS

PURPOSE OF THE REVIEW

To assess Overseas Territories' (OTs) performance against international standards and good practice as set out broadly in the Guidance Notes[3].

To make recommendations for improvement where the OTs fall below these standards.

REGULATION OF FINANCIAL ACTIVITY

The review should list separately the type and composition of offshore financial services business in each OT ie. Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands. It should ascertain what legislation, regulations, rules, guidance, systems, and procedures (statutory or otherwise) govern the regulation and supervision of the:

- banking sector;

- insurance sector;

- securities sector, including mutual funds and stock exchanges.

This assessment should cover the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulation and laws.

The review should evaluate to what extent arrangements in the OTs meet standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to relevant standards provided by these bodies are broadly set out in the

Guidance Note covering this section. The review should consider the adequacy of the system of supervision relative to the objectives of an OT's financial services regulation. It should comment on the existence and adequacy of depositor and investment protection schemes. The review should determine whether further action is required by any territory in order to meet the standards broadly set out in the relevant Guidance Note, and prioritise recommendations.

REGULATION OF COMPANIES, PARTNERSHIPS, TRUSTS

The review should supply a breakdown of the type and composition of the company, partnership, and trust sectors in each OT, including company and trust service providers and formation agents, the involvement of professionals (accountants and lawyers), and the scale of activity. It should determine and assess the legislation, framework, systems, rules, regulations, guidance and procedures in place which provide for the regulation of activity in these sectors. The review should establish whether these arrangements conform to good practice and standards outlined in the relevant Guidance Note, which in turn refers to the principles set out in: the Basel Committee on Banking Supervision; International organisation of Securities Commissions (IOSCO); the Financial Action Task Force 40 Recommendations; Caribbean Financial Action Task Force Aruba Recommendations, the International Accounting Standards Committee, the G22 report on Transparency and Accountability (October 1998), IMF Guide to Progress in Strengthening the Global Financial Architecture (April 1999) and the OECD Principles of Corporate Governance.

The review should evaluate the appropriateness of the regulatory measures in place, including the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulations, and laws.

Furthermore, it should ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts. The review should detail the type of information available on the activities of company, partnership and trust. It should determine whether the mechanisms in place are sufficient. The review should also consider whether further action is required by any territory to meet the standards broadly set out in the Guidance Note, and prioritise recommendations.

INDEPENDENT REGULATORY AUTHORITIES

The review should evaluate to what extent regulatory authorities comply with accepted international standards advocated, principally, by Basel, IOSCO, OGBS and IAIS.

In particular, the review should evaluate whether regulatory authorities are accountable, independent and free from business and political influence, and properly staffed and budgeted for, with an independent source of income. It should determine whether the authority is detached from the marketing of financial services and where this is not so any impact this may have on the ability of the regulatory authority to regulate the sector objectively. The review should assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance, and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; cooperate with requests for assistance from foreign authorities and; enforce rules, regulations, laws by taking enforcement action, and the extent to which they can liaise with law enforcement authorities in the sharing of information. The review should consider which activities fall under the responsibility of the regulatory authority, and whether the regulatory net covers all financial activities. it should comment on the resources available to the authority, both for the purpose of recruitment, training and retention of staff and its infrastructure, such as the use of technology.

The review should consider what legal advice is available to the authority and its effectiveness in helping the OT government to regulate the sectors.

INTERNATIONAL COOPERATION

The review should evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of OT law enforcement and regulatory authorities to cooperate with requests for assistance from foreign authorities. The necessary requirements are broadly set out in the relevant Guidance Note. The review should ascertain what legal advice is available to OT regulatory and law enforcement authorities and its effectiveness in helping the OT government to co-operate in these areas. The review should determine whether further action is required by any territory in any of these areas, and the relative priority of such action.

<u>Cooperation between regulatory authorities</u>

The review should consider whether there are effective 'Gateways' provisions in place; OTs' powers to obtain information, including by compulsion; ability of foreign authorities to take voluntary testimony from OT residents; an OT's ability to safeguard the confidentiality of information provided by foreign counterparts; provisions governing conditions under which information may be passed to overseas jurisdictions; whether effective Memoranda of Understanding exist, where required to underpin cooperation.

Cooperation between law enforcement authorities

The review should assess the extent of cooperation to which OT law enforcement authorities can obtain evidence on behalf of their foreign counterparts, and exercising other available mutual legal assistance powers, stating the mechanisms and OT authorities involved; an OT's ability to assist foreign authorities in tracing, freezing and confiscating proceeds in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (November 1990), even if the underlying conduct takes place outside the OT; the effectiveness of Mutual Legal Assistance Treaties with the USA where applicable, and the provision of basic statistics on the volume of requests for assistance made and received; powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted; ability to safeguard the confidentiality of information provided to OT authorities; whether effective Memoranda of Understanding exist, where required to underpin co-operation.

Cooperation between regulatory and law enforcement authorities

The review should evaluate whether there is effective cooperation

between law enforcement authorities and financial regulators, both domestically and abroad, as specified by the G7 key 10 principles. It should also consider the ability of OT regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

MEASURES TO COMBAT MONEY LAUNDERING

The review should establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the OT to combat money laundering, and types of offences caught by the legislation. It should determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.

The review should evaluate the effectiveness and adequacy of these arrangements, in terms of how they meet the standards broadly set out in the relevant Guidance Note, which in turn refers to: 1988 UN Drugs Convention; FATF 40 Recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990), and CFATF Aruba Recommendations. Furthermore, it should consider to what extent the OTs apply standards set out by the EC Money Laundering Directive (June 1991), the standards on which UK anti-money laundering legislation is based.

Specific consideration should be given to those offences considered predicate for the purposes of money laundering legislation; whether OTs have regulatory legislation in addition to the principle money laundering offences, and if not, whether guidelines and/or Codes of Practice exist (statutory or otherwise); their systems for reporting suspicious transactions and identifying customers; the institutions obliged to report; how reports are dealt with; and within what timeframe. The review should consider how this information is disseminated and shared with foreign counterparts. It should evaluate ability of Financial Intelligence Units (FIUs), or equivalents, to deal with suspicious transactions ie. whether staff have been properly trained and capable of conducting financial investigations and analysis; the resources at their disposal; feedback to the financial institutions.

The review should determine to what extent the AttorneyGeneral's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws. This not only relates to the prosecution of cases but the provision of assistance to foreign jurisdictions in pursuance of money laundering legislation.

FORMAT OF REPORT AND TIMESCALE

FCO, HM Treasury and OT representatives will wish to agree with KPMG the precise format of the report during Phase 1 of the workplan.

KPMG should provide written monthly reports to the Steering Committee (in electronic form) and attend Committee meetings at least during Phases 1, 2 and 5 (dates to be agreed).

10 December 1999

THE SUPERVISION OF THE BANKING, INSURANCE AND SECURITIES SECTORS

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories states that the Overseas Territories (OTs) should seek to implement "*legislation for the effective regulation of the offshore sector which fully meets accepted international standards*". In many cases the OTs have already implemented some of the standards, but no attempt is made here to analyse individual territories' performance to date. Such an analysis is the objective of the independent review foreseen in the White Paper, and to attempt it in the context of this paper would result in a superficial and incomplete impression of where matters stand. Instead, the purpose of this paper is to provide an overview of the framework within which international standards relating to the regulation of banking, insurance and securities business are established, and to offer an outline of the broad standards that have evolved. The paper is not intended to act as a substitute for the study of the detailed documents published by the respective standardsetting organisations, primarily the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to these documents can be found in the following text and, specifically, in publications available on the respective websites. The following are also key documents:

Core Principles for Effective Banking Supervision	Basel Committee	Sept 1997
The Supervision of CrossBorder Banking	Basel Committee	Oct 1996
Insurance Principles, Standards and Guidance Papers	IAIS	Oct 1998
Objectives and Principles of Securities Regulation	IOSCO	Sept 1998

THE OBJECTIVES OF SUPERVISION

2. The objectives of financial services supervision fall into four broad categories:

to secure the appropriate degree of protection for consumers of financial services;

- to maintain confidence in the financial system;
- to promote public understanding of the financial system; and
- to reduce the scope for financial crime.

3. The protection of consumers' interests does not assume an absolute objective to prevent financial consumers from losing money, but rather to create an environment where financial risk is better understood, and where there is less chance of consumers taking unnecessary and excessive risks. As stated in a recent Occasional Paper published by the UK's Financial Services Authority, this process requires "*having regard to the differing degrees of risks involved in different kinds of investment, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions*"[4]. Delivery of the appropriate environment involves both proper transparency and disclosure by financial institutions, and the effective enforcement of laws, regulations and rules by the regulators.

4. Preservation of confidence in the financial system has at its core the need to mitigate the risk of systemic failure, or of the system falling into disrepute. This will not necessarily be focused on the narrow issue of whether individual depositors or investors are threatened with the loss of money, but on whether the system as a whole might be under threat from the failure of one or more institution. There are circumstances in which individual financial institutions can and should be allowed to fail without fear of a threat to the system, even though there might be losses for the customers of those institutions.

5. The rising tide of financial crime has increasingly posed threats to the integrity of financial systems. This impacts upon both the financial stability of institutions and upon the reputation of individual jurisdictions. Although financial services supervisors are not expected to police the wider criminal laws, it is clearly important for the supervisors to play their part in reducing the exposure of the financial services sector to criminal abuse, and in tackling financial crime and regulatory abuse. This requires OT regulatory authorities to have appropriate investigative powers and specialist enforcement branches, and to cooperate fully with the authorities in other jurisdictions. The responsibility for investigating individual cases of money laundering should, however, fall to OT law enforcement authorities.

THE SUPERVISORY FRAMEWORK

6. Perhaps the single most important aspect that underpins the integrity of the financial services sector is a longterm political commitment to effective regulation and supervision. Without such commitment the regulators will always be starved of the tools needed to achieve an effective result.

7. Fundamental to this process is a willingness to enact comprehensive regulatory legislation, to develop the associated regulations, rules and guidance, and to keep this structure under review to ensure that it stays abreast of trends both in the financial services industry itself, and in the development of regulatory practices. While the individual techniques of supervision and enforcement may vary in order to address the respective distinctive features of the offshore and domestic sectors, the fundamental standards applied to the offshore sector should not differ from those expected for the domestic market. With regard to the offshore sector, it is essential that due regard is paid to the regulatory implications in tandem with any moves taken to facilitate the development of business. Moreover, there should be no attempt to encourage "regulatory arbitrage" by seeking to offer a lighter regulatory regime than exists in competitor jurisdictions.

8. A central part of the legal framework must be provision for an effective, operationally independent and accountable regulatory authority with the appropriate powers to fulfil the objectives identified in section 2. However, legal form alone is not sufficient to provide the basis for an effective regulatory system. There needs also to be an allocation of resources in line with the structure, scale and complexity of the financial services sector. This involves an acceptance of the need to invest in the staff and infrastructure of the regulatory authority in order to ensure that it has appropriate skills and tools to meet the tasks expected of it. It has also to be recognised that there can be no formalistic approach to the funding of the regulatory regime, based, for example, on the direct benefit derived by government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision. By entering the offshore market a jurisdiction has to accept that not only does it have a duty to preserve the reputation and standing of its own financial system, but that it also assumes a wider responsibility to the international community to help ensure the integrity of the global market.

THE DEVELOPMENT OF INTERNATIONAL STANDARDS

9. The increasing internationalisation of financial services in the past decade has led to a drive to establish some common minimum standards of supervision. The application of these standards is seen as particularly important in financial centres with a high proportion of international business, since the failure of supervision there may have far wider implications than simply for the local market.

10. Standards for the supervision of the banking sector have been developed over many years under the auspices of the Basel Committee on Banking Supervision which promulgated the first Basel Concordat in 1975. In recent years there has been a rapid increase in publications emanating from Basel, many of which are intended to represent accepted international standards. Although the Basel Committee is an organisation whose membership comprises the G10 countries, it has a number of "regional" affiliates, not least of all the Offshore Group of Banking Supervisors, which have been closely involved in the development of the standards in recent years. The list of publications produced by the Basel Committee is available on the website of the Bank for International Settlements (www.bis.org). In the context of this paper the most significant of the documents are *The Core Principles for Effective Banking Supervision* (published in September 1997), which delivers 25 basic principles, and *The Supervision of CrossBorder Banking* (published in October 1996), which contains 29 recommendations.

11. In the insurance sector standards are increasingly being established by the International Association of Insurance Supervisors (IAIS). The IAIS was established in 1992 and has membership of about 100 jurisdictions, including several offshore centres. Until 1996 it had no standardsetting powers, but since that time has produced a number of standards and guidance papers. These are consolidated within the *Insurance Principles, Standards and Guidance Papers* published in October 1998. The IAIS standards focus on particular supervisory issues, describing the best or most prudent practices, while the guidance papers are designed to assist regulators to raise the effectiveness of supervision. The IAIS is in the process of developing a website which should be available shortly.

12. The primary international standards body in the securities sector is the International Organisation of Securities Commissions (IOSCO). Like the Basel Committee, IOSCO has been working over many years and published its first *Resolution on the Regulation of Securities Markets* in 1983. Unlike Basel, its membership is big (over 90 countries) and includes a large number of emerging markets and offshore centres. IOSCO's bylaws include clear objectives, with which all members are expected to comply. They include the requirements for members to cooperate, to promote high standards of regulation, to apply the standards rigorously, to establish effective surveillance and enforcement, to maintain just, efficient and sound markets, and to exchange information. In September 1998 IOSCO published its *Objectives and Principles of Securities Regulation* which sets out the 30 Core Principles of securities regulation. In addition, IOSCO has over the years

produced a substantial range of other documents which represent commitments by the membership, guidance or standards, and which are available on its website (www.iosco.org).

13. Although membership of these standardsetting organisations, or their affiliates, has been open to offshore centres, acceptance of, and compliance with the principles that the organisations espouse are essential preconditions for membership.

OVERVIEW OF THE COMMON PRINCIPLES

14. It has to be reiterated that the documents referred to in this paper are essential reading, and it is not the intention of this paper to provide a substitute summary. However, in considering the structure of the overall regulatory regimes required in the OTs it is important to identify the common themes that underpin the regulation of all three sectors. This section seeks to highlight these themes. However, it is important to appreciate that, while there are common characteristics of the regulation of the different sectors of the financial services industry, different skills and processes will be required to effect proper regulation of each sector. The reference documents address these differences.

A. General Principles

a) Regulation should be vested in a properly constituted authority which should be operationally independent from political and commercial interference in the exercise of its functions. However, it should also be openly accountable in the exercise of its powers (see also the separate paper on *Independent Regulatory Authorities*).

b) The regulatory authority should have a clear, adequate, achievable and consistent framework of responsibilities, objectives and powers set by legislation, and it should adopt processes which are fair, consistent, transparent to the public, and demonstrably geared towards achieving the objectives.

c) The regulatory authority should have adequate funding to enable it to acquire the resources (staffing, technology, infrastructure etc) to fulfil its responsibilities. The funding should be available in such form that it does not compromise the authority's independence from both political and commercial pressures.

d) The regulatory authority should have due regard to the need to compete with the commercial sector for skilled staff, and should structure its terms and conditions of employment accordingly. It should also ensure that its staff receives ongoing training.

e) The system of supervision should involve both offsite surveillance and onsite examination. This requires the regulatory authority to have the powers not only to set the scope, content and frequency of routine reporting by regulated institutions, but also to have access, whenever it considers it appropriate, to the books, records, accounts and other documents maintained by the institutions. There should be no secrecy barriers to limit the regulators' access to information.

f) The regulatory laws should establish proper licensing standards and criteria, and the regulatory authority should adopt effective procedures to ensure that applications are reviewed in a thorough and consistent manner. As a minimum this should require the implementation of comprehensive due diligence procedures in relation to controllers, directors and managers of prospective licensees, and a detailed analysis of an applicant's business plan, internal controls, projected financial condition and likely ability to comply with established prudential standards.

g) The regulatory laws should provide for notification of any intended change in ownership or control of a regulated institution, and for such changes to be subject to prior approval by the regulatory authority.

h) The regulatory authority should have the powers to implement and enforce prudential standards both generally across the entire sector, and specifically in relation to individual institutions. For example, this requires that the authority adopt and enforce suitable standards for capital adequacy, solvency, liquidity, risk concentration, asset valuation etc, taking account of accepted international standards and guidelines.

i) The regulatory authority should require institutions to maintain minimum standards of corporate governance, internal controls and operational conduct with the aim of protecting the interests of clients, ensuring proper management of risk, and accepting primary responsibility for these matters. Careful attention should be paid, for example, to the role and responsibilities of the board of directors, the arrangements for delegating authority and responsibility, the separation of duties, the safeguarding of assets and the procedures for internal audit.

j) Regulated institutions should be required to maintain proper books, records and accounts.

k) There should be procedures for dealing with the failure of a market intermediary in order to minimise damage and loss to financial consumers and to contain systemic risk.

1) The regulatory authority should be vested with comprehensive and credible inspection, investigation, surveillance, and enforcement powers, including

- powers to take action to ensure compliance with regulatory requirements;
- powers to impose administrative sanctions for noncompliance;
- powers to initiate or refer matters for criminal prosecution; and
- powers to suspend or revoke authorisation to conduct business.

m) Regulated institutions should be subject to independent external audit in accordance with international accounting standards, and should be required to disclose to the public information regarding their activities and financial position that is comprehensive and not misleading. This information should be sufficient for financial consumers and market participants to assess the risk inherent in individual institutions.

n) The establishment of trading systems, including securities exchanges, should be subject to regulatory authorisation and oversight. Trading should be supervised in a way which ensures that the integrity of the market is maintained. There should be fair and equitable rules which strike an appropriate balance between the demands of different market participants.

o) Market regulation should promote the transparency of trading, be designed to detect and deter manipulation and other unfair trading practices, and aim to ensure the proper management of large exposures, default risk, and market disruption.

p) Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and be designed to ensure that they are fair, effective and efficient, and reduce systemic risk.

q) The regulatory system should set appropriate standards for the eligibility and regulation of collective investment schemes; provide for rules governing their legal form and structure, and for the segregation and protection of client assets; require disclosure necessary for evaluating the suitability of a scheme for particular investors; and ensure that there is a proper and transparent basis for the pricing and redemption of units.

r) The regulatory authority should have the powers and procedures to ensure that regulated institutions take action to protect themselves against criminal misuse, and that they maintain appropriate systems to comply with anti-money laundering regulations.

B. Cross-Border Issues

a) The regulatory laws and supervisory policy and procedures of a jurisdiction should seek to ensure that no institution operating across national boundaries escapes supervision, and that the supervision should be effective. In this context attention should be paid not only to corporate structures that might frustrate effective consolidated supervision (e.g. parallel-owned entities), but also to arrangements where the physical location of the licensee's mind and management differs from that of the regulator (e.g. shell branches).

b) The creation of a crossborder establishment in the regulated sector should be subject to prior consultation and agreement between the home and host regulators. This is essential not only to ensure proper assessment of the application, but also to enable both parties to agree the necessary procedures for ongoing supervision of the institution.

c) The regulatory authority should be empowered to collect both public and nonpublic regulatory information, and to share this in accordance with international principles with domestic authorities and foreign counterparts. Co-operation in the exchange of such information involves exchanges of a routine nature and the provision of assistance in an enforcement investigation, as well as in the event of the emergence of serious problems (see also the separate paper on *International Cooperation*).

d) The regulatory authority should have the powers to assist an overseas regulator in the fulfilment of its functions. This may involve assistance in obtaining information or records, but will also extend to the use of investigative or

compulsory powers on behalf of the overseas regulators. Secrecy or confidentiality provisions in the law of a jurisdiction should not be used as a means of impeding such assistance.

e) There should be no barriers to prevent a home country regulator from undertaking such procedures, and having access to such information in the host country as it considers necessary to undertake the effective consolidated supervision of an international financial services group.

THE FUTURE DEVELOPMENT OF STANDARDS

15. The rate of development of internationally recognised and accepted regulatory standards has accelerated in recent years, and further announcements should now be expected on a regular basis. Therefore, it is important to appreciate that compliance with international standards is not a static or "oneoff" process, but will require regular updating of laws, policies and procedures. With this in mind, regulatory authorities in the OTs should continue to monitor international developments, particularly where they participate in or are affected by the work of one or more of the key international standardsetters mentioned above. They should, in particular, be prepared to recommend changes in legislation where appropriate, and to implement new procedures to ensure that compliance is kept up to date. This applies in all three of the main sectors referred to in this paper.

IMPLEMENTATION

16. Standardsetting is not, by itself, enough. It needs to be accompanied by active monitoring of compliance with these standards, and the commissioning of the independent review of the OTs must be seen in the wider context. The G7 report on *International Financial Architecture*, agreed at Cologne, said:

"*With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation*."

17. The standardsetting regulatory bodies the Basel Committee, IOSCO and IAIS are now working increasingly closely with the IMF and the World Bank. In the field of banking supervision, for example, the Basel Committee, the IMF and the World Bank, working with selected supervisors around the world, have developed a *Core Principles Methodology* text which provides detailed guidance to the IMF and World Bank for their assessments of compliance. It is expected that such assessments will be made for an increasing number of countries and territories around the world; and that the results of such assessments will be used by regulators (see for instance the Basel Committee's consultative paper on a *New Capital Adequacy Framework*) and by the Washington institutions (as a precondition in the IMF's new Contingency Credit Line).

18. An IOSCO Implementation Committee, in which the IMF, World Bank and the regional development banks participate, has been set up to oversee the implementation by IOSCO members of the 30 Core Principles. Cooperation between IOSCO and the international financial institutions is at the heart of this process.

COMPANIES AND TRUSTS

1. There are legitimate reasons for using company and trust vehicles. However, the White Paper "Partnership for Prosperity" (Appendix 2, paragraph 4) states "We shall also press Overseas Territory governments to introduce legislation to improve regulation of company formation and management because, for example, in the absence of proper regulation, complex company structures can be used to disguise the proceeds of crime and other regulatory abuse as well as providing limited liability." The White Paper continues "Company formation agents and company managers need to be required by law to hold key information about the companies for which they have responsibility and to disclose that information to a regulator on request. This will ensure a properly documented paper trail for criminal and regulatory investigations."

2. This paper considers the issues of company and trust regulation relevant to the regulation of the financial system. The paper does not set out a blue-print for Company and Trust Law and regulation as a whole - that would be outside the scope of the Review, and constitute a major undertaking in its own right. The two sectors - companies and trusts - fulfil very different purposes, and their regulatory regimes have evolved in different ways, to meet different objectives. Nevertheless, in respect of their potential as vehicles for abuse, the issues raised by the trust and company sector are similar, and for this reason, this paper treats them in parallel. But the Review may wish to consider them as distinct sectors.

4. The opportunities for companies and trusts to be used for criminal purposes cannot be removed. Effective regulation can help reduce the scope for criminal abuse of such vehicles. There is no single international group of company and trust regulators. Nevertheless, the regulatory principles established by other international bodies in relation to other financial sectors apply equally well to the company and trust sectors:

The principle that financial institutions should know their customers (established by - among others - the Basle and IOSCO standards) applies with particular relevance to situations in which the ownership of assets may be obscured through company and trust vehicles;

FATF Recommendation 11 requires financial institutions "*to take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located)*". The interpretative note to this recommendation states "*a bank or other financial institution should know the identity of its customers, even if these are represented by lawyers....accordingly, recommendation 11 also applies to the situation where an attorney is acting as an intermediary for financial services*". This accepted international standard implies that financial institutions should be able to delve beneath a corporate or trust structure, to establish the true beneficial owner and other relevant parties, and not simply the name of a lawyer acting as an intermediary.

The FATF's Recommendation 25 states "*Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities*";

International standards on accounting, disclosure and auditing practice; covering timeliness in the provision of financial information, completeness, consistency, risk management, audit and control. The relevant standards include those set by the International Accounting Standards Committee; the G22 report on transparency and accountability, October 1998; and the IMF *Guide to Progress in Strengthening the Global Financial Architecture*, April 1999). These standards are particularly relevant when there are obligations to third parties arising;

Standards of corporate governance, reflected in the *OECD Principles of Corporate Governance*, which OECD members, in co-operation with the World Bank and IMF, are committed to promoting amongst non-member countries;

The Home Office report on "*Financial Regulation in the Crown Dependencies*" (The "Edwards Report") makes specific recommendations, based on the internationally accepted principles outlined above, for the company and trust sectors of the Isle of Man, Guernsey and Jersey.

5. Satisfying these principles implies the following;

(i) Beneficial ownership.

It should be possible for law enforcement and regulatory authorities to ascertain, quickly and efficiently, and in advance of formal proceedings, the true owner of assets held by a company or trust, and the source and nature of financial transactions. It is essential to be able to trace the ultimate individual beneficial ownership of companies and to get beyond elaborate structures in which companies are owned by layers of other companies and/or trusts, which obscures the ultimate owner.

In the company sector, this would involve the OT authorities having the means to identify company directors and the beneficial ownership of shares, eg where nominees exist. Effective custody arrangements would need to be in place in relation to bearer shares. In the trust sector, OT authorities should have the means to be able to identify the settlor, the beneficiaries, the trustees, the protector, and the custodian, where applicable, and should be able to obtain a copy of the trust instrument. This would help identify 'sham' trusts, for example. OT authorities should have the means to obtain up-to-date information, and to obtain such information in relation to companies and trusts which might be established in other jurisdictions, yet which might be managed or move to the OT concerned.

(ii) Anti-money laundering systems.

Intermediaries providing corporate or trust services should have in place effective anti-money laundering measures, including "know your customer", record keeping, and staff training requirements. Suspicious transactions involving companies and trusts should be disclosed to a Financial Intelligence Units. (More details on anti-money laundering standards are set out in the 'Money Laundering Guidance Note').

(iii) Transparency of financial arrangements.

Basic financial information relevant to the activities of companies and trusts should be available, quickly and efficiently, and in advance of formal proceedings, to law enforcement and regulatory authorities. Ideally, such information in the company sector should also be available to customers, shareholders, suppliers and lenders, where appropriate. In the trust sector, trustees should ideally be held accountable to the beneficiaries by preparing regular accounts, where appropriate,

which might also be available to the settlor and protector where applicable.

The Review will wish to consider in which circumstances it would be appropriate to require accounts to be produced, in which circumstances such accounts should be made public, in which circumstances abbreviated accounts might be acceptable, and in which circumstances the requirement to produce accounts should not be applied. The latter might apply where single asset holding vehicles exist with no third party involvement.

(iv) Obligations on directors, trustees, and company and trust service providers.

Measures should be in place to ensure that directors and trustees fulfil their "due diligence" obligations effectively, and to prevent nominees from assigning their responsibilities to others through general powers of attorney, and being used as a cover for criminal activities and regulatory breaches. More generally, those who provide corporate and trust services should be licensed, and subject to effective regulation. The "four eyes" principle should apply. The codes which apply to company and trust managers should be complementary, for example to avoid a situation in which inter-linking ownership of company and trust vehicles can be used to obscure beneficial ownership. OT authorities should be able to identify the true directors and owners of a company, and the settlors, beneficiaries, trustees, protectors, and custodians of a trust. The rules, regulations, and laws relating to insolvency and bankruptcy should also be examined by the Review, to ensure that these may not be abused, eg for the purpose of defrauding shareholders.

(v) Investigative and enforcement powers.

OT authorities should be able to apply full investigative powers to those (eg directors, beneficial owners, settlors, beneficiaries, trustees, nominees) who are suspected of criminal activity. This extends to applying the compulsory powers referred to in the paper on 'International Co-operation'. OT authorities should be able to identify the links which may exist between companies and trusts. OT authorities should launch appropriate investigations in the face of bankruptcy and insolvency. More generally, the regulation of company and trust service providers and formation agents needs to be accompanied by effective and independent enforcement powers, including the power to monitor and supervise licensed formation agents and service providers, to inspect their activities, to investigate potential breaches of rules, regulations, and laws, and to take appropriate enforcement action. The latter would include the ability and willingness to take disciplinary action (eg remove licences) as well as to pursue civil and criminal sanctions.

(vi) Removal of impediments to asset tracing and seizure.

Trust and company arrangements should not be able to be used to frustrate the due process of law in attempts to trace and seize assets.

INDEPENDENT REGULATORY AUTHORITIES

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories explains that one of the "key components of the regulatory package we wish to see in place by the end of 1999" is "the establishment of independent regulatory authorities meeting accepted international standards". The Financial regulation checklist appended to the White Paper provides further detail on what this amounts to.

2. Four publicly available papers provide more specific details on what the international community expects from a regulatory authority. These documents are (i) "Objectives and Principles of Securities Regulation" by the International Organisation of Securities Commissions; (ii) "Core Principles for Effective Banking Supervision" by the Basle Committee on Banking Supervision; (ii) "The Supervision of Cross-Border Banking" by the Basle Committee on Banking Supervision and the Offshore Group of Banking Supervisors; (iv) "Insurance Principles, Standards and Guidance Papers" by the International Association of Insurance Supervisors.

KEY FEATURES

(i) Independence

3. Independence is required in order to generate confidence, in particular that all market participants will be treated objectively and fairly, and that rules and regulations will be applied uniformly in such a way as to protect investors and promote orderly market activity. These objectives will not be satisfied unless the regulatory authority is clearly seen to act independently, and to have sole responsibility for regulating market activity.

4. The concept of independence does not imply that regulatory authorities are unaccountable. Instead, it implies that their day to day operations should be free from political or commercial control and influence. These executive operations include all the regulator's key functions, such as (a) deciding to issue, suspend, and withdraw licences; (b) supervising and inspecting the activities of licence holders, including issuing rules and regulations; (c) undertaking investigations; (d) taking enforcement action, and; (e) co-operating with overseas authorities. The regulatory authority should have the necessary powers and ability to regulate all licensed activity.

5. Proper independence requires the regulatory authority to exist as a stand-alone body, rather than as eg a separate unit within the Finance Ministry. Independent regulatory authorities are typically established by statute, which sets out the authority's powers and responsibilities. Those working in the authority, including senior management, should not have any external commercial or political interests or responsibilities (including unpaid directorships). The regulatory authority should not be required to secure OT government approval before exercising its executive powers.

6. Independence extends to the authority's functions. The regulatory authority should not be charged with any political or commercial responsibilities. In particular, the authority should not seek to market its jurisdiction as a place for business to locate. All such hard selling and marketing should be undertaken by a separate body which is not connected in any way with the regulatory authority (again, members of staff should not work in both bodies). Such separate promotional bodies should not be funded by the regulatory authority. Essentially, the job of selling the merits of doing business in a particular OT should be left either to OT governments or to the private sector. It would, however, be open to the regulatory authority to provide information about the regulatory regime in the jurisdiction to potential inward investors.

7. Independence extends to the way in which the authority is resourced. Regulatory authorities should be self-supporting and have their own source of income, independent from Government control. This is often raised through licence fees or another form of industry levy. Where these fees currently account for a large proportion of OT government income, the authority would return any excess income to the government.

8. Independence does not imply isolation. The regulatory authority should consult both the industry and the OT government before seeking to make any changes to broad regulatory policy, and before seeking to make changes which have national policy implications, or which have significant implications for the industry. These implications can properly include considerations of internal and external competitiveness, within the parameters of relevant international standards.

(ii) Accountability

9. Independent regulatory authorities are subject to a number of checks and balances, which in turn ensure that they are held accountable for their actions. In particular;

(a) Statutory objectives. The objectives of the authority should be laid down by statute drawn up by the OT Government. These objectives should reflect the need to satisfy internationally accepted standards of regulation.

(b) Appointments. The authority should operate under a properly constituted board or Commission, which holds a mix of relevant expertise. All board/Commission members should be appointed on the basis of that expertise by the OT Government, or by the Governor in consultation with the OT Government (eg where the Governor retains responsibility for the offshore sector). All key policy decisions should be approved by the board.

(c) Legislation. Legislation covering financial regulation as a whole will often need to be amended or introduced in order to make any significant changes to the regulatory regime. Regulatory authorities do not normally have the power to make such legislation, and will need the support of those who do if significant changes are to be made to the regulatory regime.

(d) Annual report. The authority should produce an annual report available to the public explaining its operations over the past year, how its objectives have been tackled, how resources have been allocated, and how it intends to tackle its objectives in future. This would include publishing a set of audited accounts and possibly a Statement of Principles. The annual report should identify where problems have been encountered in meeting international standards, and how the authority intends to deal with these problems. OT Governments should question the authority in relation to its annual report.

(iii) Functions and powers

10. The documents mentioned in paragraph 2 provide full detail on the types of function expected of a regulatory authority. For the purposes of this paper, it is worth noting simply that the regulatory authority should have sole responsibility and

powers in the following areas. These functions relate to the regulation of activity;

(a) Licensing. The regulatory authority should have sole responsibility for issuing, suspending, and withdrawing licences. This extends to having the powers and ability to investigate whether persons are 'fit and proper' to work for a licensed firm.

(b) Determining how licensed firms and persons should conduct business. The regulatory authority should have sole responsibility for setting conduct of business rules and regulations, and providing guidance for market practitioners. Where legislation is required, the authority should be able to make proposals to OT governments.

(c) Supervising and monitoring licensed activity. The regulatory authority should monitor all licensed activity. This would involve establishing regular (eg quarterly) reporting systems plus a programme of regular and 'surprise' inspections. The regulatory authority should not require the prior approval of any external body before conducting such inspections.

(d) Investigating. The regulatory authority should conduct in-depth investigations into suspected breaches of rules, regulations, and laws. The regulatory authority should have the power to compel the production of information from both licensed and unlicensed firms and persons, in the ways outlined in the paper on 'International Co-operation'. In particular, the regulatory authority should not pursue criminal investigations outside the regulatory function - the law enforcement authorities should be responsible for leading those investigations.

(e) Taking enforcement action. The regulatory authority should have the powers to take appropriate enforcement action in response to breaches of rules, regulations, and laws. This would include the ability to suspend and withdraw licences, the ability to issue directions, and the ability to levy fines. Where criminal activity is encountered, lead responsibility for taking enforcement action would normally fall to the law enforcement authorities in conjunction with the prosecuting authorities.

(f) Co-operating with other authorities. Where serious breaches are encountered, the regulatory authority would be expected to co-operate fully with other authorities within the OT, such as prosecuting and law enforcement authorities. This would essentially involve the regulatory authority handing over information it had obtained before it became clear that criminal activity was at hand, rather than the regulatory authority undertaking any criminal investigations. OT authorities should also co-operate fully with authorities based overseas, in the ways outlined in the paper on 'International Co-operation'.

(iv) Resources

11. The regulatory authority should be properly resourced in order to meet these responsibilities effectively, and a certain critical mass is required. This includes having access to legal and accountancy advice from sources which do not suffer from a conflict of interest. Regulatory authorities should have their own source of stable ring-fenced income, independent from Government or other political control and influence. This income is often raised from the industry in some way.

12. As stated in the paper 'The Supervision of the Banking, Insurance, and Securities Sectors', resources should be allocated 'in line with the structure, scale, and complexity of activity. The funding of the regulatory regime should not be based on the direct benefit derived by the OT Government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision'.

(v) Liabilities

13. Regulatory authorities are normally subject to statutory immunity from prosecution, in order to allow them to conduct their regulatory functions more effectively. Other jurisdictions are more likely to recognise this immunity if the regulatory authority matches up to international standards, in the ways outlined above. The converse is also true.

14. Properly resourced regulatory authorities which perform their functions in the ways envisaged by the documents mentioned in paragraph 2 are also much less likely to get into the sorts of situation where their actions might be subject to legal challenge. For example, the regulatory authority should be able to demonstrate that any problems did not arise as a result of substandard regulation.

INTERNATIONAL CO-OPERATION

INTRODUCTION

1. By their very nature, offshore centres conduct business which is linked with that in other financial centres. For this reason, it is important that offshore centres cooperate fully with requests for assistance from authorities in other jurisdictions. This includes both regulatory and law enforcement authorities. The types of assistance referred to in this paper do not include co-operation relating to fiscal matters.

2. The White Paper on Britain and the Overseas Territories explains that one of "the key components of the regulatory package we wish to see in place by the end of 1999" is "powers to ensure that, whatever the secrecy laws, regulators and law enforcement in those Overseas Territories with financial sectors can cooperate properly with their overseas counterparts, including on investigation and enforcement matters".

3. Assistance should extend to;

(i) Regulatory authorities sharing confidential regulatory information held on file or obtainable from licensed bodies.

(ii) Regulatory authorities obtaining information by compulsion from unlicensed bodies, and obtaining client information by compulsion from licensed bodies (where clients refuse to disclose this information voluntarily).

(iii) All such exchanges of information between regulatory authorities to take place under cover of a bilateral Memorandum of Understanding signed by each party, setting out the terms and conditions of assistance, including that the confidentiality of information provided must be safeguarded.

(iv) Law enforcement authorities providing assistance to their foreign counterparts covering all financial crimes (not just those related to money laundering or drugs-related offences), extending to investigative assistance before court proceedings have been issued, and providing for evidence to be obtained on their behalf.

(v) OT regulatory authorities allowing information disclosed to a foreign regulatory authority to be disclosed in turn by them to a foreign law enforcement authority, but only with the OT's prior consent, which may extend to placing conditions on how that information might be used.

GATEWAYS: A PRECONDITION FOR INFORMATION EXCHANGE

4. Where confidential information is exchanged with a foreign authority, or between different authorities within the same jurisdiction, confidentiality should be safeguarded. Confidential information should only be exchanged where provided for in law. Confidential information should only be passed to *bona fide* authorities which can safeguard its confidentiality, and these safeguards should be established in law. Similarly, legislation in Overseas Territories should provide OT authorities with the power to safeguard the confidentiality of information they may have received from foreign authorities.

5. All Overseas Territories should have in place statutory 'gateways' which enable confidential information to be exchanged with foreign authorities. This would include all forms of information of interest to the authorities, including information relating to individuals, bank accounts, trusts, and companies. 'Gateways' legislation should override any secrecy and confidentiality provisions in OT law, to the extent that it should allow confidential information from all sources to be passed to a foreign authority, as long as that authority could in turn safeguard its confidentiality.

6. It is possible that foreign regulatory authorities might be compelled by Court order in their country to disclose confidential information obtained from an OT authority. In these circumstances, the OT authority's prior consent should be sought before any confidential information is disclosed to the Court. If such consent is not forthcoming, the Court should be made aware by the foreign authority that any compulsion to disclose may damage relations between regulatory authorities, to the detriment of future regulatory co-operation, and that this would not be in the public interest.

CO-OPERATION BETWEEN REGULATORY AUTHORITIES

(i) Types of co-operation

7. Gateways *per se* do not provide for adequate co-operation. They simply allow confidential information to be exchanged. Gateways need to be supplemented by powers which enable OT authorities to obtain information (either for their own purposes, or on behalf of foreign authorities), and subsequently to exchange this with foreign authorities.

(i) Supervisory information

8. OT regulatory authorities should be able to obtain, in the course of their normal duties, information relating to the supervision of licensed firms and persons. OT regulatory authorities should be able to exchange this information with their foreign counterparts.

(ii) Voluntary testimony

9. Representatives from a foreign regulatory authority should be allowed to visit an OT with the consent of the OT regulator, and take testimony from individuals and firms who voluntarily consent to being questioned by a foreign regulatory authority. Before approving a request to take voluntary testimony, the OT regulator should be satisfied (i) that the request comes from a *bona fide* foreign regulatory authority, and relates to their regulatory responsibilities, (ii) that the request relates to a specific line of investigation, and (iii) that the confidentiality of any information provided will be safeguarded.

(iii) 'Compulsory' powers

10. These are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT. Following discussions at the past three Attorney Generals' Conferences, a draft Model Ordinance providing for compulsory powers is now well developed (attached at Annex B).

11. Annex A provides more details on how these powers would operate in practice. Because individuals and firms are *compelled* to provide information, there are tight constraints and conditions on the use of these powers, and OT regulatory authorities would have discretion in deciding whether to use them on behalf of an overseas authority. It is worth noting here that;

(i) Compulsory powers should only be used in certain specific circumstances. Incoming requests for information, which will require the use of OT compulsory powers to obtain it, should be vetted by the regulatory authority's lawyers (or an OT Magistrate/Court) within a specific time frame, in order to verify that compulsory powers may be used. Information obtained by compulsion may also be vetted by the regulatory authority's lawyers before final disclosure to a foreign authority;

(ii) Information obtained by compulsion should not be used as evidence against the provider in any subsequent criminal proceedings. The OTs will wish to decide whether to preclude it being used as criminal evidence against third parties;

(iii) Compulsory powers are used only at the very early stages of an investigation, when the investigator does not know whether criminal activity is at hand. Compulsory powers should no longer be used if/when it becomes clear that only criminal activity is involved, and hence that the investigation should be taken forward by the law enforcement authorities (once a suitable request for assistance has been made through other channels);

(iv) Strict terms and conditions on the use of compulsory powers should ensure that they cannot be abused to go on 'fishing trips', that the Overseas Territories retain discretion over their usage, and that they should not be used when it would be more appropriate to go though other channels (eg Mutual Legal Assistance Treaties (MLATs)).

12. Subject to these conditions, information obtained by compulsion may be disclosed to the law enforcement authorities, who as a result may seek to obtain criminal evidence (via other channels). Information obtained by compulsion may help indicate where criminal evidence may be obtained, ie may lay the ground for further requests for assistance via other channels by foreign law enforcement authorities.

13. In summary, these powers are used to uncover facts during the very early stages of an investigation, before it is clear what has taken place, in order to gain a picture of what happened. When it has become clear what happened, the authorities may choose whether to take no action, whether to take disciplinary action, whether to consider civil proceedings, or whether to consider criminal proceedings. Criminal evidence would need to be obtained via other channels (ie agreements between law enforcement authorities) in order to pursue a criminal prosecution. In the UK's experience, compulsory powers are rarely used on behalf of a foreign authority (about ten times per year).

(ii) Memoranda of Understanding

14. It is common practice between regulatory authorities for the terms and conditions of information exchange and

investigative assistance to be set out in a Memorandum of Understanding signed between the authorities which will be co-operating with each other. Memoranda of Understanding usually require requests for assistance to be framed in terms of the specific activities which are being investigated by the foreign jurisdiction - eg they can prevent authorities going on 'fishing trips' in another jurisdiction.

15. Memoranda of Understanding should only provide for the exchange of confidential information when the foreign regulatory authority has demonstrated that they will be able to safeguard the confidentiality of information provided by the OT regulator. Memoranda of Understanding should specify explicitly how confidentiality will be safeguarded, and should set out the terms and conditions of onward disclosure, eg to a foreign law enforcement authority. It is common to allow a foreign regulatory authority to disclose information obtained (eg from an OT regulator) to another foreign authority, but only with the consent of the OT regulator in this example. Memoranda of Understanding should specify what terms and conditions apply to the use of compulsory powers, and this may include specifying how information provided may be used.

16. Memoranda of Understanding are not legally binding documents, nor are they any form of legislation. They are simply an agreement between two regulatory authorities. For this reason, they tend to be tailored to the degree and nature of assistance available in each jurisdiction. Separate MoUs tend to apply to each sector (ie banking, securities, and insurance), although eg an MoU in the securities field would still provide for the exchange of information on bank account details (where this was connected to a breach of regulations or laws concerning securities).

17. Further precise details on international standards relating to Memoranda of Understanding are set out in publications by the Basle Committee, IOSCO, and the IAIS. The IAIS paper 'Insurance Principles, Standards, and Guidance Papers' includes in an Annex a model MoU in the field of insurance. IOSCO have published separate guidance titled 'Principles for Memoranda of Understanding'.

18. An Overseas Territory regulatory authority may still exchange information with a foreign authority if a Memorandum of Understanding is not in place. The terms and conditions of such exchange would need to be agreed on a case by case basis. Memoranda of Understanding essentially provide a framework which allows information to be exchanged without the terms and conditions of such exchange having to be negotiated on each separate occasion. Memoranda of Understanding are therefore more relevant between jurisdictions which exchange regulatory information regularly.

CO-OPERATION BETWEEN LAW ENFORCEMENT AUTHORITIES

(i) Types of co-operation

19. Assistance should be available to foreign law enforcement authorities in relation to all forms of financial crime, rather than just drugs-related offences or money laundering. This would include fraud, insider-dealing, and market manipulation. An OT should be able to provide assistance even though the activity under investigation might not be a criminal offence in that OT. In these circumstances, OT law enforcement authorities will wish to consider whether there is a good reason to provide assistance, or whether it would be in the public interest not to provide assistance.

20. OT law enforcement authorities should be able to provide investigative assistance, and should be able to obtain evidence on behalf of their foreign counterparts. As with regulatory co-operation, assistance should be provided in response to specific requests. Investigative assistance should be made available before court proceedings have been issued, and ideally without the prior need for a Treaty to exist between the countries in question.

21. These objectives would be satisfied if the Overseas Territories were to adopt measures equivalent to those in the UK's Criminal Justice (International Co-operation) Act 1990, which provides for UK authorities to co-operate with judicial and prosecuting authorities in other countries in criminal proceedings and investigations. Many OTs have already introduced equivalent legislation. It is for OTs to decide whether they wish to satisfy the objectives specified here by adopting equivalent legislation or by choosing other means. It is worth noting here that assistance should be available to all *bona fide* foreign law enforcement authorities with genuine requests.

22. It is not common for Memoranda of Understanding to be signed between law enforcement authorities, if only because the types of co-operation required are often provided for by international Treaties. Nevertheless, there is nothing to prevent Memoranda of Understanding from being adopted, especially if OT law enforcement authorities wish to adopt bilateral agreements specifying exactly how assistance might be provided.

23. Memoranda of Understanding are generally easier and quicker to devise and modify than bilateral Treaties. For this reason, an OT is unlikely to be able to co-operate effectively in the ways envisaged with a wide range of countries over a wide range of areas if it seeks to negotiate, sign, and manage a set of bilateral Treaties with all foreign law enforcement

authorities which seek assistance.

(ii) Seizing assets

24. International co-operation should extend to tracing, freezing, and confiscating the proceeds of crime, and their value, on behalf of overseas authorities. Powers to trace assets for authorities in other jurisdictions should be exercisable regardless of banking secrecy and, preferably, on an agency to agency basis as well as through central authority channels. Powers to restrain and confiscate assets which represent the proceeds of crime should be on an all crimes basis, as envisaged in the 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime.

25. No assets should be immune from seizure, either by virtue of OT laws or other arrangements providing for asset protection, or by virtue of arrangements (eg in trust instruments) which require assets to 'flee' to another jurisdiction when there is a chance that they might be seized. These arrangements for asset seizure should apply to all financial crimes, ie not just drugs-related crimes or money-laundering, even though a crime may not have been committed in an OT.

CO-OPERATION BETWEEN DIFFERENT TYPES OF AUTHORITY

26. The G7 have recently adopted a set of ten principles concerning the extent to which regulatory and law enforcement authorities should work with each other, including when different types of authority are based in different jurisdictions. In general, different types of authority (regulatory and law enforcement) should be able to exchange information with each other and to provide each other with investigative assistance, subject to specific terms and conditions set out in Memoranda of Understanding. This does not imply that regulatory authorities should take on the role of 'international tax policemen'.

27. In practice, an OT regulatory authority would assist a foreign law enforcement authority by passing information to a foreign regulatory authority, and allowing them (with prior consent) to disclose this to a law enforcement authority in their jurisdiction. Domestic regulatory authorities do not tend to deal directly with foreign law enforcement authorities. If this arrangement is to work effectively, there need to be effective gateways and working relations between regulatory and law enforcement authorities in the same jurisdiction.

28. This should not, however, prevent OT regulatory authorities from dealing directly with foreign regulatory authorities which also happen to possess certain law enforcement and prosecuting responsibilities. In this instance, the Memorandum of Understanding between respective regulatory authorities would need to specify clearly how any information disclosed might be used.

ANNEX A: COMPULSORY POWERS (OR INVESTIGATIVE POWERS)

A1. Compulsory powers are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. In the context of regulatory co-operation, OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT.

A2. Compulsory powers may be used to obtain information from both licensed and unlicensed firms and persons. This includes ordinary members of the public as well as all financial institutions, companies, and trusts. Compulsory powers may be used to obtain all types of information, including details of beneficial ownership, personal bank details, and personal telephone records.

A3. Compulsory powers override all other secrecy and confidentiality provisions in law - ie they may be used to obtain information from bank accounts, companies, and trusts, even if other laws declare that all such information should not be disclosed. Confidential information would only be disclosed to a foreign regulatory authority if they could safeguard its confidentiality.

Use of compulsory powers

A4. These wide-ranging powers are used at the very early stages of an investigation to gain an understanding of what happened - ie which activities took place where, and who was involved with what. Compulsory powers are used infrequently, as regulatory authorities normally have a clear understanding of what happened, especially where 'know your customer' guidance is actively implemented and licensed firms and persons are willing to assist the authorities.

A5. Compulsory powers are used to undertake fact finding investigations, rather than to obtain criminal evidence. Information obtained by compulsion may be used by the regulator to take disciplinary or civil action. Because information is obtained by compulsion, it cannot be used as evidence in criminal proceedings against the provider.

A6. Furthermore, the 'rules of evidence' which exist in most countries normally prescribe how evidence may be obtained, and this tends to involve questioning under police caution: ie the very nature of compulsory powers normally prevents any information obtained from being used as evidence in criminal proceedings. OT regulatory authorities may in addition wish to specify in Memoranda of Understanding signed with foreign counterparts that information obtained by compulsion cannot be used as evidence in criminal proceedings.

A7. Compulsory powers should not be used to provide assistance to a foreign regulatory authority if it would be more appropriate to use other channels (eg Mutual Legal Assistance Treaties (MLATs)). It is for the requested authority to determine the appropriate channels in line with commitments entered into in any MoUs or Treaties. In practice, compulsory powers should only be used when it remains possible that civil action may be taken as a result of the investigation at hand. As soon as it becomes clear during the investigation that the authorities are faced with only criminal activity, compulsory powers should no be longer used. At this stage, the law enforcement authorities should be left to pursue a criminal investigation (and overseas law enforcement authorities should seek assistance via other channels).

A8. Within this framework, compulsory powers can still be used to assist law enforcement authorities, but only at the very early stages of an inquiry, when it remains unclear what happened, and hence whether civil or criminal sanctions (or none) would be appropriate. Information obtained by compulsion essentially lays the ground for criminal investigations undertaken by law enforcement authorities, should it transpire that criminal activity is at hand. Compulsory powers would be used before a foreign law enforcement authority is in a position to make a request for assistance from an OT law enforcement authority (eg via MLAT).

A9. In this limited sense, the use of compulsory powers may lead to criminal prosecutions. In practice, an OT regulatory authority would not deal directly with a foreign law enforcement authority. Instead, OT regulatory authorities would deal with their foreign counterparts, and then allow (with prior consent) their foreign counterparts to disclose information received to foreign law enforcement authorities.

Who investigates?

A10. Investigations are usually undertaken by the domestic regulatory authority on behalf of the overseas regulator. It is normal for these powers to be vested with the head of the regulatory authority, although an alternative may be to vest them with the Governor or Minister of Finance (depending on who is ultimately responsible for regulation of the offshore sector).

A11. Whoever holds these powers may authorise an officer of his or any other competent person to exercise them. If an OT so wishes, it is possible for an OT regulator to allow an overseas regulator to operate as an authorised agent of theirs and use these powers directly. The decision on who to appoint is normally made on a case by case basis.

A12. Payment of the costs of exercising these powers can be made a condition for providing assistance. This normally happens when the balance of requests tends to be one-sided, rather than domestic and overseas authorities seeking broadly equivalent assistance from each other.

Constraints and discretion in exercising compulsory powers

A13. The exercise of investigative powers after a request is not inevitable, nor is the disclosure of information obtained by their exercise. The powers can only be used to assist an overseas authority having specified regulatory functions, and then only for the purposes of those functions. Assistance should be provided when there is a good reason to do so (this hurdle is normally relatively easy to satisfy).

A14. The information which is obtained through the exercise of investigative powers can be disclosed only if a gateway exists. If there are concerns about how the confidentiality of the information provided will be safeguarded once in the hands of the overseas regulator, or if, as a result of the investigation, doubts have arisen about the authenticity of the overseas regulator's claim to need the information for its regulatory functions, the OT regulatory authority should discuss its concerns with the foreign regulatory authority before disclosing any information.

A15. Assistance should be provided in response to individual requests, which should specify what information is sought and the purpose for which it is sought, including details of the laws, rules or regulations which it is alleged have been breached and of the conduct which gives rise to the breach. The draft model OT Compulsory Powers Ordinance (attached) requires that the following factors be taken into account when deciding whether to exercise compulsory powers on behalf of a foreign authority;

Whether corresponding assistance would be given to the OT;

Whether the inquiries relate to a breach of law which has no parallel in the OT (although assistance may still be provided in these circumstances, if there is a good reason to do so);

The seriousness of the matter in question, the importance to the investigation of exercising compulsory powers, and whether assistance could be obtained by other means (eg MLATs);

Whether it is in the public interest to provide assistance.

A16. Each request for assistance should be vetted by the OT regulatory authority to ensure that it is made by a foreign authority which has the necessary functions and that the request is made for the purpose of its regulatory functions. The requesting authority must demonstrate that a substantial line of enquiry is being pursued - its request should not be a "fishing trip" for information. In practice, the OT regulatory authority would also vet all information obtained by compulsion, to ensure that information disclosed to a foreign authority relates to the specific request made. This vetting would normally be undertaken by the OT regulatory authority's legal advisers. The draft model OT Compulsory Powers Ordinance also provides for an OT Magistrate or Court to approve the use of compulsion, within a short time frame. Under the draft model OT Compulsory Powers Ordinance, it is a criminal offence not to provide information under the exercise of compulsory powers.

ANNEX B: DRAFT COMPULSORY POWERS MODEL ORDINANCE

A Bill entitled:

An Ordinance to make provision for assisting overseas regulatory authorities to obtain information:

ENACTED BY the Legislature of [the Caribbean Overseas Territory] as follows:

1. This Ordinance may be cited as the ******** Ordinance, 1998.

2. In this Ordinance:

"competent authority" means any authority specified in [the Schedule to this Ordinance] [an Order made by the Governor];

["Director" means the Director of Financial Services;]

"foreign regulatory authority" means an authority which, in a country or territory outside [the Caribbean Overseas Territory], exercises functions corresponding to any functions of a competent authority under any Ordinance, or exercises any function [prescribed for the purposes of this section by an Order made by the Governor, being a function] which in the opinion of the Governor relates to companies or financial services;

"Governor" means the Governor in Council;

"regulatory functions" means functions of a competent authority under any Ordinance or any functions corresponding to such functions, and any other functions relating to companies or financial services, not being the functions of assessing, imposing or collecting taxes.

3. (1) Subject to subsection (2), the powers conferred by section 4 are exercisable by the [Director] for the purpose of assisting a foreign regulatory authority which has requested assistance in connection with inquiries being carried out by it or on its behalf.

(2) The [Director] shall not exercise the powers conferred by section 4 unless he is satisfied that the assistance requested by the foreign regulatory authority is for the purposes of its regulatory functions.

[(2A) The [Director] may decline to exercise the powers conferred by section 4 unless he is satisfied that information furnished pursuant to the exercise of those powers will not be used in any criminal proceedings against the person furnishing it (other than proceedings for an offence under section 7 or for an offence of perjury, or for any like offence).]

(3) In deciding whether to exercise those powers, the [Director] may take into account, in particular:

(a) whether corresponding assistance would be given in the relevant country or territory to an authority exercising regulatory functions in [the Caribbean Overseas Territory];

(b) whether the inquiries relate to the possible breach of a law, or other requirement, which has no close parallel in [the Caribbean Overseas Territory] or involves the assertion of a jurisdiction not recognised by the [the Caribbean Overseas Territory];

(c) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in [the Caribbean Overseas Territory] and whether the assistance could be obtained by other means;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

[(4) For the purposes of subsection (3)(a), the [Director] may require the foreign regulatory authority requesting assistance to give a written undertaking, in such form as the [Director] may determine, to provide corresponding assistance to an authority exercising regulatory functions in [the Caribbean Overseas Territory].

(5) Where a foreign regulatory authority fails to comply with a requirement made under subsection (4), the [Director] may refuse to provide the assistance sought.]

(6) The [Director] may decline to exercise the powers conferred by section 4 unless the foreign regulatory authority undertakes to make such contributions towards the costs of their exercise as the [Director] considers appropriate.

(7) In subsection (3)(a), "relevant country or territory" means the country or territory from which the request for assistance is made.

4. (1) Where in accordance with section 3 the [Director] is satisfied that assistance should be provided pursuant to a request by a foreign regulatory authority, he may in writing direct any person -

(a) to furnish him with information with respect to any matter relevant to the inquiries to which the request relates;

(b) to produce any documents relevant to those inquiries; or

(c) to give him such assistance in connection with those inquiries as the [Director] may specify.

[(3) The [Director] may examine a person on oath and may administer an oath accordingly.]

[(3A) Where a person fails to comply with a direction given under subsection (1) within three days from the date of the direction or such longer period as the [Director] may permit, the [Director] may apply to [a Magistrate] [the court] for an order requiring the person to comply with the direction.

(3B) Where pursuant to a direction given under subsection (1) the [Director] considers it necessary to examine a person on oath, [the Director] may apply to [a Magistrate] [the court] to have that person examined by [the Magistrate] [the court] and the results thereof transmitted to the [Director].

(3C) [A Magistrate] [the court] shall process an application under subsection (3A) or (3B) within seven days and, in the case of subsection (3B), [he] [it] shall transmit the results of the examination to the [Director] within a reasonable period not exceeding fourteen days.]

(4) Where documents are produced pursuant to this section the [Director] may take copies or extracts from them.

(5) A person shall not under this section be required to disclose information or produce a document which he would be entitled to refuse to disclose or produce on grounds of legal professional privilege in proceedings, except that a [lawyer] [barrister or solicitor] may be required to furnish the name and address of his client.

(6) Where a person claims a lien on a document, its production under this section is without prejudice to his lien.

(7) In this section "documents" includes information recorded in any form; and, in relation to information recorded otherwise than in legible form, the power to require its production includes power to require the production of a copy of it in legible form.

5. (1) The [Director] may:

(a) [seek the assistance of the Commissioner of Police in the exercise of his powers under this Ordinance; or]

(b) authorise an officer of his or any other competent person to exercise any of those powers.

(2) No such assistance shall be sought or authority granted except for the purpose of investigating -

(a) the affairs, or any aspect of the affairs, of a person specified by the [Director]; or,

(b) a subject matter specified by the [Director];

being a person who, or a subject matter which, is the subject of the inquiries being carried out by or on behalf of the foreign regulatory authority.

(3) No person shall be bound to comply with a requirement imposed by a person exercising powers by virtue of an authority granted under this section unless he has, if required, produced evidence of his authority.

(4) Where the [Director] seeks assistance or grants an authority under subsection (1), the assistance or authority shall be provided or executed in such manner as the Director may determine; and where the Director grants such an authority to a person other than one of his officers, that person shall make a report to the [Director] in such manner as he may require on the exercise of that authority and the results of exercising it.

6. (1) No information which

(a) is supplied by a foreign regulatory authority in connection with a request for assistance, or

(b) is obtained by virtue of the exercise of powers under this Ordinance, shall, except as permitted by subsection (2), be disclosed for any purpose by the primary recipient, or by any person obtaining the information directly or indirectly from him, without the consent of the person from whom the primary recipient obtained the information and, if different, the person to whom it relates.

(2) Information to which subsection (1) applies may be disclosed:

(a) to any person with a view to the institution of, or otherwise for the purpose of:

(i) criminal proceedings;

(ii) disciplinary proceedings relating to the exercise by a barrister, solicitor, auditor, accountant, valuer or actuary of his professional duties;

(iii) disciplinary proceedings relating to the discharge by a public [servant] [officer] of his duties;

(b) for the purpose of carrying out any duty imposed under any law in force in [the Caribbean Overseas Territory] or by any international agreement to which [the Caribbean Overseas Territory] is a party;

[(c) on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings;]

(d) for the purpose of enabling or assisting a competent authority to discharge any of its functions under any Ordinance;

(e) to the [Governor/Attorney General/public officer approved by the Director] [in the public interest];

(f) if the information is or has been made available to the public from other sources;

(g) in the form of a summary or collection of information framed in such a way as not to enable the identity of any person to whom the information relates to be ascertained;

(h) to a foreign regulatory authority for the purpose of its regulatory functions.

(3) In subsection (1) "the primary recipient" means, as the case may be -

(a) the [Director];

(b) any person authorised under section 5; or

[(c) the Commissioner of Police or any of his officers.]

7. (1) A person who

(a) without reasonable excuse, refuses or fails to comply with any [direction given by the [Director]] [order of [a Magistrate] [the court]] under section 3;

(b) intentionally furnishes false information in purported compliance with any such [direction] [order];

(c) with intent to avoid the provision of this Ordinance, destroys, mutilates, defaces, secretes or removes any document;

(d) otherwise wilfully obstructs any inquiry to which a request from a foreign regulatory authority relates; or

(e) contravenes section 6;

commits an offence.

(2) A person who commits an offence under this section is liable .....

8. No suit shall lie against the [Director] or any person acting under his authority for anything done by him, in good faith, in the exercise of any power or the performance of any function under this Ordinance.

9. This Ordinance shall come into [force] [operation] on such date as the Governor may by proclamation appoint.

MONEY LAUNDERING

INTRODUCTION

1. Money laundering is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises. It is, in effect, the interface between the illegal business sector and the financial sector. Estimates of the size of the phenomenon are hard to come by, but it is generally agreed that it could be in the region of 5% of GDP of the average country.

2. The activity is one of considerable concern for many reasons. If the proceeds of crime are allowed to be lodged unhindered in financial institutions, criminals can gain influence over the institutions and, perhaps eventually control them. Where criminal proceeds are used to buy legitimate businesses, competitors find themselves unable to compete and are driven out of business. Unchecked, money laundering can destabilise financial institutions, sectors and, in certain cases, entire economies. Economic crime can damage financial markets and, thus, the reputation and health of a nation as a whole. It is the concern generated by these implications that have galvanised the international community into making concerted efforts to tackle money laundering.

3. These efforts are highlighted by the following initiatives:

* the 1988 UN Drugs Convention requires parties to criminalise drug money laundering;

* the Financial Action Task Force (FATF) set up in July 1989 by the G7 specifically to develop and promote policies to combat money laundering.

* the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime November 1990;

* the EC Money Laundering Directive of June 1991 requires Member States to prevent the use of their financial systems for money laundering;

* the Caribbean Financial Action Task Force (CFATF) the first regional body to follow the FATF.

4. The White Paper on Britain and the Overseas Territories (Partnership for Progress and Prosperity) noted that the Caribbean Overseas Territories are, in particular, a potential target for money launderers. The OTs should, therefore, have in place comprehensive measures to combat money laundering.

5. The White Paper checklist acknowledged, however, that this is an area in which the OTs have already made good progress. Most have now introduced "allcrimes money laundering legislation". This legislation must, however, be enforced and reviewed regularly. To their credit, all of the OTs are members of the Caribbean Financial Action Task Force and either have, or will shortly undergo, mutual evaluations.

6. The following guidance explains what HMG means by "comprehensive measures to combat money laundering".

INTERNATIONAL STANDARDS

The FATF 40 Recommendations:

7. The 40 Recommendations set the basic framework for anti-money laundering efforts and are designed to have universal application. The principles cover the criminal justice system, law enforcement, the financial system and its regulation and international co-operation. The essential components of the 40 Recommendations are as follows:

* Each country should implement a general framework which ratifies the Vienna Convention, and increases multilateral co-operation on money laundering cases.

* Each country should criminalise money laundering in relation to serious offences, not merely drug money laundering.

* Countries should also put in place measures to enable the tracing, freezing and seizing of criminal assets and the ultimate confiscation thereof.

* The following should be required of all financial institutions, whether they be bank or non-bank institutions:

customer identification "know your customer"

record keeping 5 years

special attention to complex/unusual/large transactions

immunity from prosecution if report suspicion in good faith

internal systems including training and designation of compliance officer

application of these requirements to foreign branches

* Each country should improve spontaneous or "upon request" international information exchange relating to suspicious transactions. This requirement is subject to strict safeguards necessary to ensure consistency with national and international provisions on privacy and data protection.

* Different definitions and standards between jurisdictions should not affect the ability or willingness of countries to provide each other with mutual legal assistance.

* There should be procedures regarding the use of compulsory measures including the production of records by financial institutions.

OTHER RELEVANT STANDARDS

CFATF additional 19 Recommendations:

8. In June 1990 representatives of Caribbean and Latin American States formulated a further 19 Recommendations specifically tailored to regional laws and circumstances. These acknowledged the need to devote adequate resources to this area, the need for competent authorities to specialise in it and that improvements would be ' required to legal systems to enhance the regulation and the role of the financial sector and to improve international co-operation. In particular the CFATF Recommendations urged members to:

* consider the practical evidentiary complications of limiting money laundering to only certain predicate crimes.

* criminalise conspiracy and/or aiding or abetting drug trafficking and money laundering offences.

* to consider making money laundering an offence both where the offender knew or ought to have known the origin of the funds.

* to make money laundering an offence no matter where the predicate offence took place.

* to acknowledge that the fact that a financial adviser is an attorney is insufficient reason to invoke attorneyclient privilege.

EU Money Laundering Directive:

9. Although this has no direct impact on the OTs, it is relevant in so far as it informs the UK law. The EU Money Laundering Directive of 10 June 1991 (91/308/EEC) requires Member States to prevent the use of their financial systems for money laundering. The EU suggests three main steps to combat money laundering: criminalise it; take measures to identify laundered proceeds with a view to confiscation; pass laws and establish systems to prevent the proceeds of crime being laundered in the first place.

10. The Directive also sets out requirements to be placed on the credit and financial institutions (as defined) of the Member States' jurisdictions. This includes customer identification and retention of records, relating to identification and transactions, for a period of five years. The Directive goes on to require Member States to place a requirement on such institutions to inform the authorities about suspected money laundering activity.

The UK law and practice:

11. The UK implemented the EU Directive by means of the Criminal Justice Act 1993, the Money Laundering Regulations 1993 and earlier legislation. The principal money laundering offences are set out in the Prevention of Terrorism (Temporary Provisions) Act 1989 and the Drug Trafficking Act 1994. The Criminal Justice Act 1988, as amended, contains the money laundering offences relating to the proceeds of crimes other than drug trafficking and terrorism. These are defined as all indictable offences, other than those covered by the 1989 and 1994 Acts, plus the summary offences set out in Schedule 4 to the 1988 Act. The latter include certain lucrative offences relating to sex establishments and the supply of unclassified videos.

12. The principal money laundering offences have a dual purpose. Firstly, to criminalise and so suppress money laundering activity. Secondly, to encourage the reporting of suspicious transactions to the authorities. In this second respect, the offences help to protect the integrity of financial institutions by deterring criminals from lodging proceeds in them, and also help to provide the police with new investigative leads.

Criminal Justice Act 1988, as amended by the Criminal Justice Act 1993:

13. The money laundering offences created by this legislation are as follows:

Assisting another to retain the proceeds of crime: to commit this offence, one must know or suspect that the person in question is or has been engaged in crime, or has benefited from it.

Acquiring, Possessing or using another's proceeds of crime: the offence only applies where the launderer acquires, possesses or uses the property for inadequate "consideration,' (payment). Thus, if one pays full value for the property one does not commit the offence. The provision of goods or services which are of assistance in criminal conduct is not regarded as "consideration".

Concealing another person's proceeds of crime: This includes concealing or disguising property; or converting or transferring property or removing it from the jurisdiction. Carrying out these activities must be for the purpose of assisting somebody to avoid prosecution for a relevant offence or the making of a confiscation order against him/her. Unlike the above offences, all that is required here is "reasonable grounds for suspicion". Thus the prosecution need only prove that the person laundering the proceeds **should have suspected.**

Laundering one's own proceeds: This includes the same activities as concealing another person's proceeds and one must conceal, disguise, convert, transfer or remove property from the jurisdiction for the purpose of avoiding one's own prosecution for a relevant offence or the making of a confiscation order against oneself.

14. The penalties for all of the above offences are fourteen years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction (currently £5,000).

15. The legislation also includes the following offences:

Tippingoff offences: These apply when a money laundering investigation is being, or is about to be, conducted, and where a suspicious transaction report has been made, or a suspicion of money laundering has been disclosed to the authorities. The offence can be committed where one knows or suspects that an investigation is being conducted, or is about to be, or a disclosure has been made.

16. The penalties for tippingoff are five years imprisonment and an unlimited fine on indictment, and six months

imprisonment and a fine not exceeding the statutory maximum on summary conviction.

The Money Laundering Regulations 1993:

17. Another essential part of the UK's antimoney laundering defences are the Money Laundering Regulations. They require financial institutions to put in place systems to deter money laundering and to assist the authorities to detect money laundering activities. The Regulations apply to:

* all banks, building societies and other credit institutions,

* all individuals and firms authorised to conduct investment business under the Financial Services Act 1986,

* all insurance companies covered by the EC Life Directives, including the life business of Lloyds of London,

* all other undertakings carrying out any of the range of financial activities listed in the annex to the Second Banking Directive (89/646/EEC, SI 1992,3218). This includes bureaux de change and money transmission services.

18. The Regulations establish criminal offences for those who fail to ensure adequate systems are in place and maintained. Thus, the Regulations require:

* procedures to ensure identification of customers, maintenance of records relating to identification and transactions, or such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering;

* appropriate measures to be taken from time to time to make employees who handle relevant financial business aware of the procedures and the money laundering statutes;

* provision of training for those employees from time to time in the recognition and handling of transactions which may be money laundering.

19. Where an offence is committed by a body corporate, partnership or unincorporated association, the directors and managers and certain other people may be guilty of the offence as well. Penalties for contravention of the Regulations are two years imprisonment and an unlimited fine on indictment and a fine not exceeding the statutory maximum on summary conviction.

Money Laundering Guidance Notes:

20. In addition to the above, the British Bankers Association have produced guidance notes for the industry in association with the Building Societies Association and the law enforcement authorities. Similar guidance notes have also been produced for the insurance and investment business sectors.

COMPLIANCE WITH THESE STANDARDS

21. With regard to the OTs, we have encouraged the OTs to put in place measures equivalent to those in the UK. Most have now implemented the primary legislation. However, work on the essential supporting measures still needs to be completed.

Regulations:

22. Many OTs have opted to implement voluntary codes of practice rather than an equivalent to the UK Money Laundering Regulations 1993 (the Regulations). **To be effective these need to be placed on a statutory footing** providing for criminal offences in the event that monitoring and reporting systems are not created and maintained.

23. Effective operation of the antimoney laundering legislation relies on the vigilance of financial institutions and the reporting of suspicious transactions. While the requirement to put in place monitoring and reporting systems is voluntary, the risk of commercial interest frustrating the intent is concrete. Placing these requirements on a mandatory footing would enable the OTs to ensure that the supporting mechanisms for their money laundering defences could be enforced. It would also send a clear signal to the financial sector that "all money is not simply money", and that certain types of financial activity were unacceptable.

Resources and enforcement:

24. It is clear from the above that the creation of anti-money laundering defences requires considerable input of resources

on the part of the financial institutions. This, however, is only one part of the equation. There is little point in requiring the financial sector to report suspicious transactions if there is an inadequate ability on the part of law enforcement to respond. This means that OT Governments must devote considerable resources to ensuring that the law enforcement capacity for analysing suspicious transaction reports and, where appropriate, acting on them is sufficient. This will apply not only to reports submitted by institutions operating within the jurisdiction, but also to requests for assistance on money laundering investigations from foreign jurisdictions. It is, therefore, essential that the Financial Investigation and Intelligence Units in the OTs are adequately staffed with trained personnel capable of conducting financial investigations and analysis.

25. In addition, it will also be necessary to ensure that the Attorney Generals' Chambers and the judiciary in each OT are appropriately resourced and trained to handle the types of cases which may result from enforcement of the money laundering laws. Again, this relates not merely to prosecutions of offences within the OTs, but also to provision of assistance to foreign jurisdictions in pursuance of the antimoney laundering legislation. Where appropriate, HMG is willing to provide assistance on a short term basis. However, it will be for the OTs to ensure that they budget appropriately for these responsibilities in the future.

International co-operation and confiscation:

26. It goes without saying that a great deal of money laundering involves transactions spanning a number of jurisdictions. The more complex the transactions and the more jurisdictions involved, the harder it is for law enforcement to follow the money trail. The abolition of exchange controls in the late seventies and early eighties, and the rapid improvement in technology means that it is possible instantly to transfer money of any amount or denomination virtually anywhere in the world. Much criminal law is territorially based, and differs from jurisdiction to jurisdiction, so the investigation and prosecution of financial crime and money laundering are very dependent upon mutual legal assistance between states.

27. The confiscation and money laundering legislation which the OTs have been enacting enables many of them to co-operate in international asset tracing investigations, and in the restraint and confiscation of the proceeds of drug trafficking and other crime. Given the percentage of financial business in the OTs which has its origins in other jurisdictions, it is vital that these provisions for international cooperation are fully implemented and, when implemented, operate effectively. At a time when much attention is being focused internationally on offshore centres, it is in the OTs interests to ensure their reputation for being willing and able to assist in tracing, freezing and confiscating criminal proceeds is second to none.

28. HMG is mindful of OT concerns that they may invest considerable resources in providing investigative assistance in proceeds of crime cases, only for the assets to be confiscated elsewhere and retained by the confiscating jurisdiction. In our view, international asset sharing from which some OTs have benefited considerably in recent years provides the best way to ensure that the costs of international casework is shared equitably among cooperating jurisdictions. we strongly support the sharing of confiscated assets relating to all crimes, including drug trafficking, and are working internationally to promote progress in this area. We are happy to discuss continuing concerns about costs with the OTs, and have asked them whether they would be interested in having the Council of Europe Convention extended to their jurisdictions.

Fiscal offences:

29. International standards indicate that money laundering should be criminalised in relation to all serious crime, not merely drug trafficking. The principles leave the definition of serious crime to the individual jurisdictions. At the same time, however, **they also make it clear that such individual definitions should not affect the ability "or willingness" of countries to provide mutual legal assistance.**

30. In the UK we treat tax evasion as a serious crime so it is caught by our confiscation and money laundering legislation. We are aware that different jurisdictions treat specific tax offences in different ways. Experience suggests that this can create problems where money laundering investigations relate in some way to tax offences.

31. The "tax issue" can arise in two ways. First, the predicate offence to which the money laundering offence relates is a tax offence. Assume the predicate offence takes place in jurisdiction A and the money laundering offence takes place in jurisdiction B. A problem is created where the latter does not recognise the tax offence in question as a predicate offence to which its money laundering legislation applies. As a result it will not provide co-operation to jurisdiction A in its investigations. Second, the predicate offence may be another serious crime, such as drug trafficking. It is, however, disguised as a tax related problem to ease the process of laundering. Nonrecognition of tax offences, or non-cooperation on money laundering cases involving such offences can frustrate all sorts of criminal investigations. In either of these scenarios, the inability to cooperate where tax is, or appears to be, involved creates a loophole in the anti-money laundering defences which criminals will utilise.

32. Failure to provide adequate coverage for this issue in the antimoney laundering defences has two serious drawbacks. it makes it easier for criminals to get away with tax evasion, which we regard as a serious crime, and it undermines efforts to combat other forms of offending.

33. There is some concern that the inclusion of tax offences as predicate offences, for the purposes of the money laundering legislation, will place a requirement on financial institutions to know and understand the fiscal regimes in other jurisdictions. This is quite wrong. Under the money laundering offences one is only required to consider whether one has a suspicion of something which would be a crime in one's own jurisdiction. it is also argued that it is difficult or impossible to determine whether a transaction is indeed linked to drug trafficking, tax or any other specific crime. However, the financial institutions and their employees are not expected to investigate suspicions, but to disclose them. As noted above, in the case of the UK, this includes disclosing suspicions of tax evasion. It is worth noting, however, that cooperation on money laundering investigations involving tax offences does not necessarily require such offences to be made predicate. There may be other related offences which fall within the ambit of a jurisdiction's money laundering legislation.

34. There is also an argument that "there is no such thing as the laundering of money from tax fraud', on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime.

35. The UK's confiscation, money laundering and judicial co-operation legislation enables us to trace, freeze and confiscate the proceeds of tax evasion, or any other crime, on behalf of other jurisdictions. Where restraint and confiscation are concerned, the conduct overseas must correspond to an applicable offence in the UK. **However, much investigative assistance can be provided without any dual criminality requirement.** We can, and do, assist in foreign tax evasion cases, including cases where the conduct is not necessarily an

offence in the UK.

36. As part of the efforts to combat money laundering, the UK is encouraging others to close loopholes. We would, therefore, encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able.

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3 (Copies of Guidance Notes to be provided to Consultants.) Back

4 Clive Briault: *The Rationale for a Single National Financial Services Regulator* - May 1999 Back

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We welcome your comments on this site.

Prepared 27 October 2000

1 Executive summary

1.1 Introduction

This is one of six reports we have issued covering the Caribbean Overseas Territories and Bermuda. This report deals with Montserrat.

Montserrat is a British Overseas Territory 39 square miles (102 square kilometres) in size. The Soufriere Hills volcano destroyed much of the island's infrastructure when it erupted between 1995 and 1998 including the capital Plymouth and the airport. During this period many of the population of 11,000 inhabitants left the island. Whilst some have returned, the current number of inhabitants is only approximately 4,500.

Constitutionally, Montserrat is an internally-governing Overseas Territory. Government is run through a Governor appointed by the Crown, and Executive and Legislative Councils. The Governor retains responsibility for internal security, external affairs, defence, the public service and (importantly, in the context of this review) offshore finance. Elections are held every five years on the basis of universal adult suffrage.

The population is now located in the inhabitable third of the island. No-one is currently allowed to live in the remaining two thirds, which includes the main town, Plymouth and the island's only airport, as they are located in the "exclusion zone".

Since the volcanic eruption Montserrat has, of necessity, received additional funding from the British Government. From the start of the volcanic crisis in 1995 to 1998, Britain provided £59 million in assistance. Further sums have been allocated.

In conducting our review we recognise and understand that the focus of the island's government has been on ensuring the safety of the population and rebuilding the island's basic infrastructure. It is acknowledged by the Montserrat authorities to whom we have spoken that focus has not therefore been on financial regulation and supervision; and that such focus is now required and we are informed is being addressed.

1.2 Financial services in Montserrat

Montserrat has one of the smallest financial sectors of the six Overseas Territories under review. Indeed, with the exception of banking, it has the least offshore financial activity of any of these territories.

Whilst the volume of financial services activity has fallen significantly since the volcanic eruption there remain 15 offshore banks regulated by Montserrat. It acts as the sole regulator for nine of those. None of Montserrat's offshore banks has a physical presence in the jurisdiction.

There is no licensed offshore insurance business in Montserrat as there is no specific legislation relating to the undertaking of offshore insurance. Currently six companies with "insurance" in their name are registered as "International Business Companies".

("IBCs"). The activities of these companies are being investigated by the island's regulator, the Financial Services Centre ("FSC").

In respect of securities/investment business, there is no identified activity. The same is true of mutual fund business and stock exchange activity.

As at 22 May 2000 there were 30 Companies Act companies (primarily conducting local business) and 22 IBCs (which conduct offshore business). There are no companies registered under the Limited Liability Company Act. Similarly no limited partnerships have been registered.

As in most other jurisdictions, there is no requirement to register trusts in Montserrat. However the FSC considers the level of activity to be low, if any.

No licences have yet been granted under the new Company Management Act.

1.3 Financial services regulation

As referred to above, under the constitution the Governor has responsibility for offshore banking and financial services. Domestic insurance is the responsibility of the Minister of Finance. Day-to-day regulation is the responsibility of the FSC which comprises one full time assistant secretary in the Ministry of Finance of which the FSC is part. Recently additional part-time regulatory support and guidance has been provided, via a British assistance programme, by the Director of Financial Services in Anguilla. The supervision of domestic banks is undertaken by the Eastern Caribbean Central Bank ("ECCB").

There is legislation in place covering the regulation of banking (both domestic and offshore), domestic insurance and company managers. There is no specific regulatory legislation relating to offshore insurance, securities/investment business or trust service providers. There is an Exempt Mutual Funds Law; however this deals with the tax treatment of a certain type of fund rather than regulation of the mutual fund sector as a whole. No exempt funds are in existence.

1.4 **Summary of principal findings**

1.4.1 **Introduction**

The following matters represent a summary of our findings, and represent only the key issues arising from our review. As such they should be read in conjunction with the report as a whole.

1.4.2 **Regulatory authority**

Despite the part-time help of the Director of Financial Services from Anguilla and the efforts of the one full-time regulator in Montserrat, the resources for effective supervision remain inadequate. At least two further full time employees should be recruited, one at a senior level. Sufficient funding must also be available for training and for conducting ongoing on-site visits to Montserrat-licensed banks operating in other jurisdictions.

The FSC lacks the necessary operational independence to meet international standards as it is a government department with no direct power to make licensing and regulatory decisions. However we do not consider that it is yet in a position to become operationally independent because of the current resource constraints.

Nevertheless the current position by which the Governor is responsible for regulation but the Montserrat Government is responsible for financing the regulator is clearly undesirable: differing priorities may result in insufficient funding being made available by the Government to undertake the necessary regulatory tasks.

We therefore recommend that, for the immediate future, and with the exception of domestic banking, all regulation (including regulation of those areas currently outside of the Governor's jurisdiction) together with its financing, becomes the responsibility of the Governor. Income from licensing fees should be used to offset costs, with any surplus being passed into the general Government revenue.

We believe that this approach should be regarded as an interim measure, with the ultimate aim being to create an operationally independent regulator.

1.4.3 **Banking**

The responsibility for licensing and supervising banks in Montserrat is undertaken by two regulators. In the case of domestic banks, as stated above, this is the ECCB. Offshore banks (which are banks incorporated in Montserrat but whose activities are primarily conducted with non-residents, normally outside the jurisdiction) are regulated and supervised by the Inspector of Banking in the FSC.

The ambit of our review does not include a detailed analysis of the ECCB as this body does not come within the jurisdiction of Montserrat. Our review has therefore comprised consideration of the relevant legislation and discussions with the ECCB. We have not independently verified the accuracy of the information provided to us.

No offshore bank licensed in Montserrat maintains its accounting records in the jurisdiction. We recognise the assistance given by the Anguillan Director of Financial Services to increase the degree of supervision over these banks and that an understanding of the activities of these banks is now being attained. Nevertheless, there is at present insufficient understanding and no effective on-site supervision is currently being undertaken. Additionally a number of changes need to be made to the existing offshore banking legislation to bring it into line with international standards (including access to the records of individual customers where needed to conduct effective regulatory supervision). We therefore agree with the Government of Montserrat's view that the current position requires considerable work.

We understand from the FSC that since our on-site visit a review of all offshore banks is under way to determine which banks, if any, Montserrat should continue to license. We consider this to be a positive development.

Nevertheless, we believe that a major regulatory review of banking activity including an immediate programme of on-site inspections should be initiated, supported by improvements to the banking legislation. There are currently insufficient resources to conduct an on-site programme or to engage in effective regulatory supervision in general.

Unless this matter is rectified we consider that Montserrat has no alternative but to request that the ECCB take over the supervision of the offshore banks.

Meanwhile, there should be a moratorium on new bank licences.

1.4.4 **Insurance**

The lack of insurance legislation covering offshore activities, combined with the presence of six International Business Companies ("IBCs") which may be conducting insurance business in other jurisdictions, is a cause for concern.

We support the efforts being made to investigate these companies and suggest that this needs to be concluded rapidly and that remedial action be initiated.

If Montserrat wishes to permit firms to engage in offshore insurance business, it will be necessary to introduce legislation which covers this. Such legislation must be supported by adequate regulatory resources.

We agree with the policy of the Government of Montserrat that, until the legislative and supervisory frameworks are in place, a moratorium on this offshore activity should be continued.

1.4.5 **Securities**

The ECCB is currently preparing draft legislation covering the activities of securities and investment business. Once finalised, it proposes that it will be implemented in all eight ECCB member jurisdictions.

There are, however, potential conflicting constitutional issues concerning the role of the ECCB and that of the Governor of Montserrat in his capacity of having overall responsibility for international financial services in Montserrat. These will need to be addressed before the legislation is brought into force.

1.4.6 **Mutual funds**

As stated above, the only legislation currently in place relating to mutual funds is the Exempt Mutual Funds Act and this deals primarily with the tax treatment of a certain type of fund rather than providing a regulatory regime. However, the ECCB proposes that the draft securities law will cover the regulation and supervision of mutual funds.

We consider that a possible method for developing a legislative and regulatory structure would be through this draft Securities Act. As with securities/investment business there is a need to address any potential constitutional issues prior to doing this. The draft Securities Act may also conflict with the existing Exempt Mutual Funds law (depending on the wording in the proposed Act). If so, this will also need to be addressed.

1.4.7 **Stock Exchange**

There is currently no Stock Exchange in place in Montserrat and consequently no activity. However, an Eastern Caribbean Securities Exchange ("ECSE") is in the process of development and this Exchange will cover Montserrat together with the other seven members of the ECCB.

The lack of finalised legislation and published regulations for the ECSE limits a full and effective evaluation of the proposals against international standards and good practice.

As the ECSE is to be private sector owned and controlled and will operate as both a business and a self-regulatory organisation, we consider that strong safeguards will need to be introduced by the ECSE to ensure effective regulatory oversight. Furthermore, whilst it is proposed that regulation will be carried out formally by the ECSE, the actual obligation to do this is due to be assigned by the Securities Commission to the ECCB.

In our view, for this arrangement to meet international standards, the ECCB would need to demonstrate that they have sufficiently trained and experienced resources to fulfil their role. The ECSC will also need the necessary resources to confirm

that the ECCB are fulfilling their assigned obligations properly.

1.4.8 **Companies**

From our review it is clear that the Companies Act ("CA"), which was enacted in 1998, is a modern and comprehensive piece of legislation containing most of the features that we would expect to find. We are of the opinion that the CA is broadly compliant with the good practice standards set out in the Guidance Notes. We additionally note and welcome the fact that this legislation criminalises insider trading.

The IBC Act, which is similar to that found in a number of other jurisdictions, contains a number of deficiencies which are addressed in this report. Consequently, we do not consider that it fully complies with the good practice standards contained in the Guidance Notes. From our review, it is also apparent that the IBC Act should be subjected to a thorough review and our specific recommendations should not be considered as exhaustive.

The Limited Liability Company ("LLC") Act is of particular concern. In our view it falls short of good practice standards and should be subjected to a review. As no LLCs have yet been formed, we are precluded from reviewing how the LLC Act is operating in practice. We recommend, however, that no LLCs should be formed until the LLC Act has been brought into compliance with good practice standards.

We have also made a number of other recommendations designed to reduce the potential for companies to be used for money laundering, fraud or other illegal purposes. These are:

- the "immobilisation" of bearer shares;
- the introduction of a capability in the IBC Ordinance to disqualify a person from acting as director of a Montserrat company;
- that the names of directors should form part of the publicly available information held at the companies registry;
- that the IBC Ordinance should require that the registered agent of an IBC be a licence holder under the Company Management Act ("CMA"); and
- that the enforcement powers under the Companies Act and the IBC Ordinance be increased to include the ability of the Registrar to initiate an investigation into a company and to petition the courts to wind up a company in the public interest.

The issue of bearer shares is particularly important. Measures should be introduced whereby:

- the regulator can, where necessary, find out the ownership (through the licence holder);
- there are adequate legal powers to require this information to be kept and disclosed; and
- in appropriate cases it can then be passed, as indeed can other company information not concerned with bearer shares, to regulators in other jurisdictions, through "gateways".

1.4.9 **Company service providers**

Montserrat has recently introduced legislation, the CMA, for the regulation of company service providers. However, at the time of our visit, no action had been taken to commence the process of licensing and regulation. At that time, those currently undertaking this activity may have been doing so in breach of the new legislation. This failure to bring the regulatory regime into effect was therefore a significant concern and was seen as further evidence of the lack of financial and staffing resources available for regulatory supervision.

We have been advised that this situation is now being rectified and firms engaged in this activity had until the end of July 2000 to apply for a licence.

We also make a number of recommendations relating to the CMA and its implementation. The key ones are:

- the need to provide for "gateways" to enable the Inspector to co-operate with regulatory authorities in other jurisdictions;
- the provision of greater enforcement powers for the Inspector;

- the need for an effective on-site and off-site regulatory regime to be initiated; and
- the introduction of an enforceable regulatory code covering the way in which a corporate service provider undertakes its duties.

1.4.10 **Partnerships**

We are of the view that Montserrat meets in some respects the good practice standards set out in the Guidance Notes, but that it does not meet all of them.

In particular, we recommend that those who, by way of business, form limited partnerships or provide registered offices for limited partnerships should be licensed and subject to regulation.

A limited partnership should be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership.

We also recommend that the Registrar of Companies (who is also responsible for the registration of limited partnerships) should have enforcement powers to:

- apply to the courts for the dissolution of a partnership on public interest grounds or on grounds of fraud or insolvency; and
- apply to the courts for the appointment of an inspector to investigate the activities of a limited partnership.

1.4.11 **Trusts**

Trust legislation in Montserrat is similar to the trust legislation in a number of other jurisdictions. In general, we do not consider that there are any features of the legislation that are likely to lead to trust structures in Montserrat being considered particularly attractive to those wishing to engage in criminal conduct.

As a general point, rather than one specific to Montserrat, we recommend that legislation is amended to prevent the use of so-called "flee" clauses in trust documents to frustrate legitimate creditors or to prevent regulatory or criminal investigation.

1.4.12 **Trust service providers**

The lack of a legislative and regulatory environment for those engaging in trustee services provision is not in line with the Guidance Notes. Whilst the current level of activity is low, if any, legislation is needed as at least one company appears to be carrying on business as a trust service provider.

There is also a need for a regulatory regime to be established to supervise the activities of trust service providers.

We therefore recommend that legislation and accompanying regulation is brought in to regulate those engaged in trustee service provision.

1.4.13 **International co-operation**

Montserrat has taken a number of positive steps to improve its ability to co-operate with regulators and law enforcement bodies in other jurisdictions. In particular it has implemented a capability to assist foreign regulators in investigations of Montserrat persons and entities. This was achieved through the recent Exchange of Information Act.

There are, however, a number of areas where further development is still required. In particular there needs to be regulatory access to specific client information. We also consider that the Confidential Information Ordinance provides insufficient gateways for full co-operation to be provided to criminal authorities in other jurisdictions. The Exchange of Information Act itself also needs slight amendment to ensure its effectiveness.

1.4.14 **Anti-money laundering**

Montserrat's primary legislation is modern and reasonably extensive. It contains most of the material and covers most of the issues that we would expect to find in a jurisdiction that is fully compliant with international standards.

In particular, we are satisfied that the legislation taken as a whole enables Montserrat to comply largely with the relevant parts of the Vienna Convention and the associated FATF and CFATF Recommendations. The exceptions relate to the lack of

offences of tipping off (in drug trafficking matters) and possessing another's proceeds of drug trafficking.

Nevertheless, it is notable that no suspicious transaction has ever been reported. There are a number of other deficiencies that must be addressed as a matter of urgency as they undermine the ability of the legislation to be effectively implemented:

- there are currently no regulations or guidance notes in place to support the primary legislation; and
- a reporting authority has not been established and there is no effective infrastructure for the investigation and prosecution of money laundering offences.

1.5 **Conclusion**

It is clear from the volume of legislation relating to financial services which continues to be passed in Montserrat that the jurisdiction is committed to developing its financial services activity.

Furthermore, through the introduction of anti-money laundering legislation, the facilitation of international regulatory co-operation and the criminalisation of insider trading. Montserrat has clearly made efforts to ensure that its financial services activities are governed by an appropriate statutory framework.

Nevertheless, our review has highlighted a number of serious deficiencies in the current regulatory regime. In our view these deficiencies are principally the result of a lack of

resources both in respect of finance and manpower. These resource constraints appear to be in large part due to the effects of the volcanic eruptions on the island. These deficiencies mean that Montserrat is not in our view able to comply with the international standards and good practice outlined in the Guidance Notes. Action is therefore needed to overcome these deficiencies.

We consider that the current situation in Montserrat is one where the island could become a target for criminal activity linked to financial services. We therefore consider the remedial actions highlighted in our report are of critical importance.

Until Montserrat addresses the issues concerning banking, insurance and company management we consider that a moratorium on future growth in these financial services is the only practical solution. If Montserrat is unable to address these matters, and we appreciate the practical difficulties with a population of only 4,500 and with most of the regulatory team having left the island due to the eruptions, we see no alternative but for Montserrat to cease to offer itself as an offshore financial centre for these activities. We recognise that this is a tough conclusion. However, we have considered it carefully and believe it to be fully justified given in particular the Montserrat Government's own view that the current path is in certain respects untenable, and the lack of resources for and implementation of regulation.

We welcome your comments on this site.

Prepared 27 October 2000

2 Methodology

2.1 Introduction

2.1.1 The UK Government White Paper

The UK Government White Paper "Partnership for Progress and Prosperity: Britain and the Overseas Territories" ("the White Paper")[1] was presented to the UK Parliament in March 1999.

The White Paper recognised that the international financial service industry has grown dramatically in recent decades and that a significant number of the Overseas Territories have developed successful offshore financial sectors and so diversified their economies. The White Paper further commented that it was essential for the future of the financial services sector that the Overseas Territories reputation for honest administration and probity be preserved and enhanced.

The White Paper stated that development of sizeable financial sectors brings risk of abuse and that as markets develop and techniques for laundering money, fraud, tax evasion and regulatory abuse evolve so financial regulatory systems must improve, be updated and be responsive to ever tighter international standards.

The White Paper further stated that the Caribbean Overseas Territories in particular are a potential target for money launderers because of their offshore financial business, their proximity to major drug producing and consuming countries and, in some cases, their inadequate standard of regulation and strict confidentiality rules. The White Paper also stated that the Territories are also at risk from attempted fraud and that failure to tighten regulation could affect the stability of and confidence in financial markets. The White Paper emphasised the importance of the Overseas Territories meeting accepted international standards. To assess progress made in this area, it required an in-depth independent review to be undertaken by regulatory experts. This review was also to make recommendations as to how to deal with any issues outstanding.

2.1.2 Development of the review process

Following the publication of the White Paper, a Steering Committee was formed. This Committee comprised representatives of the Foreign and Commonwealth Office ("FCO"), the Treasury, the Financial Services Authority and the Governments of the Overseas Territories.

The Steering Committee approved the Terms of Reference ("TOR") for this review, together with Guidance Notes on international standards and good practice relating to the areas under review. We understand that the guidance on accepted international standards in financial regulation ("the Guidance Notes") contained within the TOR was arrived at following a process of detailed consultation and discussion between representatives of the Overseas Territories, the FCO, HM Treasury and the UK Financial Services Authority. These are attached in Appendix 1.

The Guidance Notes represent good practice. The Overseas Territories have therefore chosen to be assessed against standards which, in a number of areas (such as company and trust service provision), are not applied in a number of major centres. This approach demonstrates the commitment of the Overseas Territories in seeking to ensure that financial regulation in these jurisdictions will eventually meet high standards. As such they are providing a powerful role model to other offshore centres.

The Guidance Notes do not prescribe how particular standards should be achieved; rather, the Overseas Territories are left to decide for themselves how best to achieve the standards laid down in them.

On 20 December 1999 we were appointed by the FCO, acting on behalf of the Steering Committee, to undertake the review of financial regulation referred to above.

The review covers Anguilla, Bermuda, the British Virgin Islands ("BVI"), the Cayman Islands, Montserrat and the Turks & Caicos Islands ("TCI") (referred to collectively as the Overseas Territories). The White Paper covers a wider number of locations (such as Gibraltar) but this review is restricted to these six Overseas Territories.

The purpose of the review has been to assess the Overseas Territories' performance against international standards and good practice, and to make recommendations for improvement where any territory falls below those standards.

2.2 **Scope of the review**

The scope of the review was as follows:

In relation to the regulation of financial services activity

- List separately the type and composition of offshore financial services business in each Overseas Territory.
- Ascertain what legislation, regulations, rules, guidance, systems and procedures (statutory or otherwise) govern the regulation and supervision of the:

  - Banking sector

  - Insurance sector

  - Securities sector (including mutual funds and stock exchanges).

- Assess the monitoring, supervision and regulation of activity as well as the enforcement of rules, regulations and laws.
- Evaluate to what extent arrangements in the Overseas Territories meet the standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).
- Consider the adequacy of the system of supervision relative to the objectives of Overseas Territories' financial services regulation.
- Comment on the existence and adequacy of depositor and investor protection schemes.
- Determine whether further action is required by any territory in order to meet the standards set out in the Guidance Notes and prioritise recommendations.

In relation to the regulation of companies, partnerships and trusts

- Ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts.
- Detail the type of information available on the activities of companies, partnerships and trusts.
- Determine whether the regulatory mechanisms in place are sufficient to meet international standards.
- Consider whether further action is required by any Overseas Territory to meet the standards required and prioritise recommendations.

In respect of independent regulatory authorities

- Evaluate to what extent regulatory authorities comply with accepted international standards advocated principally by Basel, IOSCO, the Offshore Group of Banking Supervisors (OGBS) and IAIS.
- In particular, evaluate whether regulatory authorities are accountable, independent and free from business and political influence and properly staffed and budgeted for with an independent source of income.
- Determine whether the relevant authority is detached from the marketing of financial services and, where this is not so, assess any impact this may have on the ability of the regulatory authority to regulate the sector objectively.
- Assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; co-operate with requests for assistance from foreign authorities; enforce rules, regulations and laws by taking enforcement action; and the extent to which they can liaise with law enforcement authorities in the sharing of information.
- Consider which activities fall under the responsibility of the regulatory authority and whether the regulatory net covers all financial activities.

- Consider what legal advice is available to the authority and its effectiveness in helping the Overseas Territory's government to regulate the sectors.

In relation to international co-operation

- Evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of the Overseas Territory's law enforcement and regulatory authorities to co-operate with requests for assistance from foreign authorities.
- Ascertain what legal advice is available to regulatory and law enforcement authorities in the Overseas Territory, and determine effectiveness in helping the Overseas Territory's government to co-operate in these areas.
- Determine whether further action is required by any territory in any of these areas, and the relative priority of such action.
- Consider whether there are effective "gateways" provisions in place concerning co-operation between regulatory authorities as well as the Overseas Territory's powers to obtain information, including by compulsion, the ability of foreign authorities to take voluntary testimony from the Overseas Territory's residents and the Overseas Territory's ability to safeguard the confidentiality of information provided by foreign counterparts. In addition, determine whether there are any provisions governing conditions under which information may be passed to overseas jurisdictions and whether effective memoranda of understanding exist (where required to underpin co-operation).
- Assess the extent to which the Overseas Territory's law enforcement authorities can obtain evidence on behalf of their foreign counterparts and exercise other available mutual legal assistance powers, stating the mechanisms and the Overseas Territory's authorities involved.
- Assess the Overseas Territory's ability to assist foreign authorities in tracing, freezing and confiscating proceeds even if the underlying conduct takes place outside the Overseas Territory.
- Assess the effectiveness of mutual legal assistance treaties with the USA where applicable and provide the basic volume of requests for assistance made and received.
- Assess powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted.
- Assess the ability to safeguard the confidentiality of information provided to Overseas Territory's law enforcement authorities.
- Assess whether effective memoranda of understanding exist, where required, to underpin co-operation.
- Evaluate whether there is effective co-operation between law enforcement authorities and financial regulators both domestically and abroad.
- Consider the ability of the Overseas Territories' regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

In relation to measures to combat money laundering

- Establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the Overseas Territories to combat money laundering and types of offences caught by the legislation.
- Determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.
- Evaluate the effectiveness and adequacy of those arrangements in terms of how they meet the applicable international standards.
- Provide specific consideration to the offences considered predicate for the purposes of money laundering legislation.

- Consider whether the Overseas Territories' have regulatory legislation in addition to the principal money laundering offences and, if not, whether guidelines and/or codes of practice exist (statutory or otherwise).
- Consider the Overseas Territories' systems for reporting suspicious transactions and identifying customers, the institutions obliged to report, how reports are dealt with and within what timeframe.
- Consider how this information is disseminated and shared with foreign counterparts.
- Evaluate the ability of financial intelligence units or their equivalent to deal with suspicious transactions.
- Determine to what extent the Attorney-General's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws.

2.3 **Project governance**

2.3.1 **The Steering Committee**

The Steering Committee played a key role in setting the parameters for and guiding the conduct of the review by its involvement in:

- agreeing the TOR and benchmark standards to be applied by the review team prior to its appointment;
- offering guidance over the detailed review process through a series of Steering Committee meetings which took place at key stages in the review process; and
- agreeing the format and reviewing the content of this report and providing comment as appropriate.

The responsibility for the opinions expressed, is however, a matter for KPMG.

2.3.2 **The Strategic Team**

In undertaking the review, KPMG utilised a Strategic Team composed of former senior regulators from a number of different jurisdictions, as well as its own partners and staff. The involvement of these individuals enabled the assessment better to take into account how the standards are implemented in practice on an international basis.

Members of the Strategic Team have had significant involvement in the setting of international standards as well as their implementation. The team included a former Chairman of IOSCO's Technical Committee, the Director of Regulation at Lloyd's of London, a former Deputy Director of the United States Securities and Exchange Commission of International Affairs, a former executive Director of the Hong Kong Securities and Futures Commission and the former Chief Executive of the Isle of Man Financial Supervision Commission.

The external members of the Strategic Team provided advice and guidance to KPMG, particularly during the early stages of the project and through the initial drafting of this report. The role of the external members of the Strategic Team was advisory, however, and the analysis and recommendations in this report are the responsibility of KPMG.

2.3.3 **Responsibility for this report**

This report has been prepared by the UK firm of KPMG. Although we have associated firms in the Overseas Territories, they have not been involved in the preparation of this report, nor should any responsibility for any of the opinions in this report be attributed to them.

2.4 **Approach to the review**

2.4.1 **Structure of the report**

The individual sections of the report are generally divided into a number of parts, as follows:

- an introduction, giving a broad outline of the international standards and/or good practice against which our assessment is made;
- a description of the nature and scale of the activity in the jurisdiction;

- a factual assessment produced in conjunction with the Overseas Territory which has been formally confirmed by them as accurate; and
- a section covering the issues arising from our analysis, together with recommendations we consider appropriate to remedy any deficiencies identified.

2.4.2 **Benchmarks**

In determining the appropriate international standards and good practice we have, as instructed in the TOR, used the Guidance Notes.

In the areas of banking, insurance, securities/investments and stock exchanges there are established international standards by which compliance can be assessed. Similarly, with respect to anti-money laundering measures, the recommendations of the Financial Action Task Force and the Caribbean Financial Action Task Force provide benchmarks.

However, in other areas, such as the provision of company and trust services, there are no internationally accepted standards. The Guidance Notes have instead been based upon what has been agreed as good practice.

In accordance with the TOR we have, in conducting this review, taken due notice of the recommendations made in the recent Home Office report on the Review of Financial Regulations in the Crown Dependencies. However, the terms of reference for the two reviews are substantially different in that benchmark standards were not defined in the Home Office review and hence there was no requirement to make an assessment against them.

Accordingly, in framing our recommendations we have assessed compliance with the benchmark standards set out in the TOR.

2.4.3 **Phases of the review**

2.4.3.1 ***Legislative review***

At the outset of the review the Overseas Territories provided us with copies of relevant legislation and regulations.

2.4.3.2 ***Pre-visit questionnaires***

Prior to commencing our on-site reviews, we prepared a pre-visit questionnaire for completion by each of the Overseas Territories. The questionnaire covered the areas required by the TOR. A draft questionnaire was reviewed by the Steering Committee and their comments were incorporated prior to issue. Comments were also invited and received from other parties with experience in relevant areas, for example the FATF in respect of money laundering.

Following this consultation the questionnaire was issued and responses received from the Overseas Territories. These responses were analysed by us prior to the commencement of the on-site review.

2.4.3.3 ***On-site review programme***

The analysis of questionnaire responses was used to prepare a work programme for the on-site review. This mechanism was important in ensuring that the on-site stage of the work was completed to a consistent standard across all the Overseas Territories.

2.4.3.4 ***On-site review***

The on-site review was undertaken in March and April 2000. It comprised in excess of twenty-six man weeks in the Overseas Territories. A total of eight staff, together with two members of the Strategic Team, were deployed across the Overseas Territories. Each consultant was allocated a specific area for review in line with their sector specialism. Work was conducted in line with the on-site review programmes outlined above, adjusted where necessary for issues identified on-site.

2.4.3.5 ***Meetings with third parties***

As part of the review process we had extensive discussions and meetings with third parties (in the UK, the Overseas Territories and elsewhere) who had experience of, or an interest in, the jurisdictions under review. These third party discussions were particularly pertinent in the areas of international co-operation and anti-money laundering measures.

Meetings with the third parties referred to above included:

- The United States Securities and Exchange Commission ("SEC");
- The United States Department of Justice ("DoJ");
- Representatives of the Overseas Territories;
- The United States Federal Reserve;
- The White Collar Criminal Investigation Team ("WCCIT");
- The Overseas Territories Regional Criminal Intelligence System ("OTRCIS");
- The Financial Services Authority ("FSA");
- The National Criminal Intelligence Service ("NCIS"); and
- The Ontario Securities Commission ("OSC").

2.4.3.6 ***Findings from previous reviews***

Our review also considered the results of previous reviews of sectors of the various Overseas Territories. These included:

- the 1992/3 Bank of England "Report on the arrangements for the supervision of offshore banks", covering Anguilla, the BVI, Montserrat and the TCI;
- the CFATF mutual evaluation of Bermuda, the BVI, the Cayman Islands and the TCI; and
- the 1993 Sullivan Reports on the regulation of insurance in Anguilla, the BVI, the Cayman Islands, Montserrat and the TCI.

In addition to the above, we have used other information sources including promotional and advisory material issued by the Overseas Territories and others.

2.4.3.7 ***Reporting***

Whilst we have sought to give due credit for regulatory achievement wherever possible, it should be noted that our reports are phrased on an exceptions basis. We have identified issues and made recommendations in those areas where we consider they are required. The nature of our issues and recommendations tend to reflect the stage of regulatory development reached by the jurisdiction in question.

Those jurisdictions with more mature financial sectors and better developed regulation have tended to generate more detailed recommendations.

In those jurisdictions where we have identified a more significant lack of basic regulatory structures, our recommendations are, necessarily, focused on the major issues to be addressed. There will inevitably be many subsidiary issues which will need to be considered following action on those which are more fundamental. It is impossible to anticipate these until those more significant issues have been addressed.

2.4.3.8 ***Confirmation of factual accuracy and discussion of findings***

Following the on-site reviews, we issued initial draft reports in May 2000. We then visited each of the Overseas Territories over a two-week period at the end of May.

This second visit was designed to give the Overseas Territories the opportunity to comment on findings and confirm the factual accuracy of the initial draft reports. Comments received during the course of this visit were confirmed (where they related to issues of factual accuracy) and considered. Our draft reports were adjusted where the review team considered this to be appropriate.

Following these second on-site visits, further draft reports were prepared. These were issued on 17 July. They were also discussed with the Overseas Territories who (along with the Steering Committee) were again given an opportunity to comment. Written as well as oral comments were received from the Overseas Territories and others; all have been carefully considered.

The Overseas Territories have provided formal written confirmation of the factual accuracy of the relevant parts of our reports.

2.4.4 **Regulatory arbitrage**

Regulatory arbitrage is the selection of a jurisdiction of operation on the basis of the regulatory legislation and structure in place. Regulatory arbitrage tends to result in persons who, for their own reasons, wish to avoid regulation, selecting less-regulated jurisdictions. Consequently, less-regulated jurisdictions often become a target for money launderers and fraudsters.

All the jurisdictions have expressed a commitment to achieve the required international standards in financial services regulation envisaged by the White Paper. We consider that it should be recognised that other offshore centres, not being part of the Caribbean Overseas Territories and Bermuda, who also provide financial services and who may be regarded as competitors of the Overseas Territories, may not share the same level of commitment.

To prevent the possibility of regulatory arbitrage, even on a short term basis, the adoption of international standards should be seen as a global issue and not simply one of relevance to the Overseas Territories. Therefore, other jurisdictions should be encouraged to ensure that they introduce similar improvements and thereby facilitate a level playing field between jurisdictions.

The work of groups such as the Financial Stability Forum in raising global standards will be of importance in this area and should continue to receive strong support from both the UK and the Overseas Territories.

2.4.5 **Scope limitations and other related issues**

Our terms of reference do not provide for us to verify all the factual matters in this report, which would be a major and time consuming task. Instead, as agreed with the Steering Committee and set out in the TOR, we asked the Overseas Territories to provide us with information (including copies of relevant legislation) and to check various drafts of our reports for factual accuracy. This they have done. It should be appreciated that any further information not provided to us might alter our conclusions.

In a number of instances, sector information (for example total funds under management and analyses of a jurisdiction's main sources of business) is not collated by the jurisdiction and therefore was not available to us. In other cases available information is dated.

There was also, on occasion, a lack of available statistical information, particularly in relation to co-operation provided by the Overseas Territories to other jurisdictions. It appears that either this information is not available in a format that is retrievable to provide the statistics necessary, or it is not kept at all. The absence of such information has made certain comments on the level of co-operation provided by the Overseas Territories impossible to verify or refute. Recommendations to resolve this matter have been made in the report.

This report has been prepared for the sole purposes of a review of Financial Regulation in the Caribbean Overseas Territories and Bermuda for the Steering Committee comprising representations from the Foreign and Commonwealth Office, HM Treasury, Financial Services Authority and Governments of Bermuda, Cayman Islands and Anguilla ("the client"). It has been designed to meet the agreed requirement of the client and particular features of the engagement of KPMG determined by the client's needs at the time. This report should not therefore be regarded as suitable to be used or relied on by any person or organisation other than the client or for any other purpose or in any other context. Any person or organisation other than the client who chooses to rely on this report will do so at its own risk. KPMG will accept no responsibility or liability in respect of this report to any third party.

2.4.6 **Timescales**

Whilst we have noted areas where we consider action is required as a priority we have not set out specific timescales. We consider that the precise timescales are best determined bilaterally between the individual Overseas Territories and the Foreign and Commonwealth Office.

2.4.7 **Acknowledgements**

We are most grateful for the significant amount of time spent by representatives of the Overseas Territories, Her Majesty's Government and the other organisations whom we met.

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Prepared 27 October 2000

3 Regulatory authority

3.1 Introduction

As stated in the White Paper, a sound, transparent regulatory environment is necessary to maintain investor confidence and the reputation of the financial sector in a particular jurisdiction. This is only possible if the regulatory authority is, and is seen to be, independent.

In order to demonstrate independence, the jurisdiction must be seen to meet international standards. These standards extend beyond simple independence in the narrow sense of the term to encompass such issues as resourcing, accountability and ensuring that the regulators do not also have responsibility for marketing a territory's financial services. This theme is developed further below.

Our terms of reference cite four documents which provide specific details on what the international community expects from a regulatory authority. These documents are:

- Objectives and Principles of Securities Regulation issued by International Organisation of Securities Commissions ("IOSCO");
- Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision ("Basel");
- The Supervision of Cross-Border Banking by Basel and the Offshore Group of Banking Supervisors ("OGBS"); and
- Insurance Principles, Standards and Guidance Papers by the International Association of Insurance Supervisors ("IAIS").

These documents consider many aspects regarding the regulatory authority including licensing, supervisory and enforcement powers and the ability of the authority to co-operate with other regulatory and legal bodies.

In addition, the Guidance Notes introduce several concepts which are not explicitly referred to in the documents above but which are included in the scope of our review.

International co-operation and the powers of the regulator pertaining to the different financial sectors in the jurisdiction are dealt with later in this report. This section deals solely with the consideration of the remaining principles relating to the regulator. The Supervision of Cross-Border Banking and the Insurance Principles, Standards and Guidance papers do not refer to this subject and, as such, their content has been excluded from this report.

3.2 Principles relating to the regulator

The following section sets out the criteria underpinning what constitutes a regulatory authority which is deemed to meet acceptable international standards and the

implications for the jurisdictions under review. The sources of the criteria set out in this section are Basel principle 1, IOSCO principles 1 to 5 and the Guidance Notes.

The regulatory authority should have clearly defined responsibilities, be operationally independent and accountable, have adequate powers and resources, be consistent in its approach and observe the highest professional standards including upholding appropriate standards of confidentiality.

- Clear responsibilities

Ideally the responsibilities of the regulator should be set out in law and adequate legal protection should be provided to the regulatory authority and its staff. Legislation should be designed to avoid gaps or inequities in regulation.

- Independence and accountability

The regulator should be operationally independent from external political and commercial influence and be accountable in

the use of its powers and resources. Independence is deemed to be enhanced by a stable source of funding and would be considered to be compromised by any marketing activities carried out. Approval of decisions made by the regulator by the government or a minister does not necessarily constitute a lack of demonstrable independence providing any such consultation does not include decision making regulatory matters.

- Powers and resources

The regulator should have adequate powers and the capacity to exercise its powers, including licensing, supervision, inspection, investigation and enforcement. In many cases these powers vary across the financial sectors represented in the jurisdiction and therefore these are considered in the relevant sections of this report.

In order to exercise its tasks, the regulator must be adequately funded with the level of funding reflecting the difficulty of retaining experienced staff. Training should be provided as required on an ongoing basis. Legal advice should be readily available.

- Clear and consistent processes

The processes adopted by the regulator should be comprehensible, transparent, fair and equitable and consistently applied. On policy decisions, the regulator is expected to consult those who may be affected; it is generally desirable to make public disclosure of policy. The regulatory authority should also play an active role in the education of financial service industry participants.

- Staff conduct

The regulator's staff should observe the highest professional standards and be given clear guidance on conduct matters including on conflicts of interest, use of information obtained, fairness and the observance of confidentiality.

3.3 **Self-regulation**

IOSCO principles 6 and 7 advocate the use of self-regulatory organisations ("SROs") in appropriate circumstances, providing the SROs are subject to the continuous oversight of the regulator and observe similar standards of conduct to the regulator itself.

3.4 **Factual assessment**

3.4.1 **Clear responsibilities**

3.4.1.1 ***Constitutional position***

As referred to earlier, the responsibility for the regulation and supervision of offshore financial activities in Montserrat is constitutionally vested in the Governor and, through him, the British Government. The Financial Secretary also has a role to play under current legislation.

With the exception of registration for domestic insurance, the Governor is responsible for all licensing, revocation of licences and enforcement decisions relating to regulated firms.

The Financial Services Centre ("FSC") forms part of the Ministry of Finance. For matters not vested in the Governor under the Constitution the Director reports to the Financial Secretary. The Financial Secretary has responsibility for budgeting and administration.

There is no formal statement as to the role of the regulator, rather regulatory responsibilities are contained in the various pieces of financial service legislation in force.

As a Government function the FSC does not have its own statutory objectives.

3.4.1.2 ***Offshore business***

The day-to-day regulation of offshore financial business is undertaken by the FSC. The FSC now comprises just one person acting in a supervisory capacity. This individual reports to the Financial Secretary.

There is also a part time Inspector of Offshore Services who reports to the Governor. This person, who is also the Director of Financial Services in Anguilla ("the Director"), helpfully provides both specific and general guidance and assistance, both

through on-site visits to Montserrat as well as through ongoing assistance from Anguilla. The assistance is planned to continue until March 2001. However, the nature of the role and the individual's other commitments restrict his availability to provide assistance on more than a part-time basis in Montserrat.

3.4.1.3

Domestic banking

Responsibility for the regulation of domestic banks is vested in the Eastern Caribbean Central Bank ("ECCB"), under the Banking Ordinance 1991. The ECCB regulates domestic banking in all eight member jurisdictions and is based in St Kitts. The ECCB has a small representative office in each member jurisdiction; however, its banking supervision functions are centralised in St Kitts.

3.4.1.4 ***Securities/investment business and mutual funds***

It is proposed by the ECCB that the regulation of securities/investment business will be the responsibility of a new organisation, the Eastern Caribbean Securities Commission ("ECSC"), which will be established under the draft Securities Act currently being developed by the ECCB.

The Commission of the ECSC will comprise representatives from each member territory and a representative of the ECCB. The ECSC intends that it will also regulate the new Eastern Caribbean Securities Exchange.

Under current proposals the day-to-day supervisory responsibilities of the ECSC will be delegated to the ECCB.

3.4.1.5 ***Gaps in regulatory coverage***

We understand from the FSC that currently no-one in Montserrat undertakes the following:

- securities/investment business; or
- collective investment schemes (mutual funds/unit trusts, etc).

Details of these issues are contained in Sections 6 and 7 of this report.

3.4.1.6 ***Immunity for regulators***

The Company Management Act provides an immunity for the Governor and Inspector and any person acting on the authority of the Governor or the inspector for an act done in good faith in the discharge or purported discharge of his functions under the Act.

The Offshore Banking Ordinance provides that notwithstanding the provisions in any other law an immunity is provided to the Governor and anyone acting on his behalf for an act done in good faith in the discharge or purported discharge of his functions under the Act.

There is no indemnity/immunity provision in the Insurance Ordinance.

3.4.2 **Independence and accountability**

The FSC reports to the Financial Secretary. Ultimately it is the Governor who has responsibility for international financial services in the jurisdiction. Funding is provided via a government budget. The FSC does not produce an annual report which is available to the public.

3.4.3 **Powers and resources**

3.4.3.1 ***Introduction***

Our analysis of regulatory resources refers to Montserrat. No in-depth analysis of the ECCB has been undertaken, as control of its regulatory responsibilities lies outside the Overseas Territories and therefore does not fall within the jurisdiction of this review.

Those parts of the Guidance Notes which relate to powers and resources pertaining to international co-operation and the powers of the regulator in respect of the different financial sectors in the jurisdiction are dealt with in the sector specific sections of this report.

3.4.3.2 ***Staffing***

Regulatory staffing at the FSC is very limited and comprises one full time person. Whilst there is part-time external support, the current resources for supervision are quite inadequate.

The individual who has full-time responsibility, an assistant secretary, has been in this role for less than two years. Whilst she is an accountant she has no prior regulatory experience and has been unable (because of her workload and lack of resources) to attend necessary spreadsheet training courses.

3.4.3.3 ***Budgeting***

The budgeting process is undertaken by the Financial Secretary. The budget of the FSC for the year ending December 2000 is EC$73,470 (approximately £18,000).

3.4.3.4 ***Sources of income***

All expenditure requirements are provided from the Montserrat Government budget rather than by levies. All income generated from licensing and registration fees goes directly to the Government.

3.4.3.5 ***Legal support***

Legal support is provided to the FSC by the Attorney-General's Chambers.

3.4.3.6 ***Other resources***

The FSC uses technology but limited resources hamper its effective use. We understand from the FSC that technological upgrade is necessary to improve efficiency, but has not been implemented.

3.4.4 **Clear and consistent processes**

3.4.4.1 ***Involvement in legislative development***

The FSC has an involvement in legislative development although this is limited by available time and resources.

3.4.4.2 ***Licensing power***

Apart from domestic insurance the FSC does not have licensing powers in its own right. All licensing decisions are made by the Governor.

3.4.4.3 ***Documented procedures***

The FSC does not currently have a procedures manual covering the key elements of its work namely licensing, off-site review and on-site review. Such a manual should be regarded as representing good practice and a necessary tool where staff retention is an issue.

3.4.4.4 ***Disaster recovery plan***

No formal disaster recovery plan exists.

3.5 **Issues and recommendations**

3.5.1 **Overview**

We consider that the effort Montserrat has made to maintain regulatory standards during the recent crisis is to be congratulated. Inevitably, however, the crisis has resulted in a severe diminution in regulatory capability. As a result the current regulatory structure is not in accordance with International standards.

In addition, the current position by which the Governor is responsible for regulation, but the Montserrat Government is responsible for financing the regulator, is clearly undesirable as differing priorities may result in insufficient funding being made available to undertake the necessary regulatory tasks.

Below we discuss in more detail the issues that we consider are most urgently in need of attention.

3.5.2 **Regulatory independence**

In principle we consider that, in order to meet international standards, the FSC should become an operationally independent body with responsibility for licensing and enforcement.

Such a body should have its own funding source. This should be achieved by the regulator being the initial recipient of licence fees, passing on any surplus to the government. In order to ensure efficiency the regulator would be required to prepare budget forecasts and justify any variances by means of an annual report (which should be published).

We accept that such a transition may be difficult in the immediate future for Montserrat. Other priorities such as the development of improved regulation must take precedent. Operational independence should however be seen as a goal within the next five years.

We consider that the potential conflict between the role of the Governor with his ultimate responsibility for the majority of regulation, and the Minister of Finance as the person with budgetary responsibility, should be resolved.

We therefore recommend that, for the immediate future, all regulation (including those areas currently outside the Governor's remit) together with its financing, becomes the responsibility of the Governor. Income from licensing fees should be used to offset costs, with any surplus being passed into the general government revenue.

We believe that this approach should be regarded as an interim measure, with the ultimate aim, as stated above, being to create an operationally independent regulator.

3.5.3 **Trans-national regulatory support**

Consideration should also be given as to how best to maximise regulatory resource effectiveness within the constraints inevitable in a small jurisdiction.

We have considered whether it is practical or desirable to create a regulator which, like the ECCB, is trans-national. In this instance it could cover the Overseas Territories for whom the UK Government has ultimate regulatory responsibility, namely Anguilla, Montserrat and the Turks and Caicos Islands.

We do not consider such an approach to be viable. This is partially due to the geographical distance between the jurisdictions but also because of the importance of having senior regulators permanently present in the jurisdiction they are supervising.

Nevertheless we consider that some pooling of regulatory skills would maximise the effectiveness of the regulatory resources available, enabling effective supervision to be undertaken on a cost effective basis. For example, one jurisdiction may have a significant insurance sector, so requiring a full-time experienced supervisor, while another may only have a small insurance sector and therefore may require a similarly skilled regulator but not have sufficient need for a full-time resource.

In order to create an effective regulatory environment this issue needs to be addressed. This can be achieved in a number of ways including:

- greater co-operation between jurisdictions in sharing regulatory resources, particularly in respect of regulatory development projects (for example developing on-site supervision programmes);
- shared training;
- greater sharing of resources in the carrying out of investigations or dealing with major regulatory issues; and
- the use of secondments, from both smaller to larger centres to gain experience and from larger to smaller centres to enable skill sharing.

Such an approach would need to overcome a number of key factors including cost allocation and the competition between the jurisdictions for business (although the Overseas Territories are committed to avoiding regulatory arbitrage).

A current example of this is the work of the Anguilla Director of Financial Services in assisting the regulator in Montserrat, as previously referred to.

We therefore recommend that consideration is given to assessing the merits of formalising of such a resource sharing process.

3.5.4 **Staffing**

We consider the current staffing of the FSC to be below that needed to operate an effective regulator.

Given the additional work needed to be undertaken, at least one further full-time senior member of staff should be recruited together with one assistant.

In addition to the immediate remedial issues highlighted in this report, further short-term support is needed, particularly with carrying out on-site reviews of all licensed banks.

3.5.5 **Relationship with the Eastern Caribbean Central Bank**

As a member of the ECCB, Montserrat may be able to utilise its resources in a number of respects. These are set out in the following sections of this report. The effect of such assistance would be to alleviate some of the resource difficulties currently experienced within Montserrat.

We welcome your comments on this site.

Prepared 27 October 2000

4 Banking

4.1 Introduction

There are established international standards in place concerning the regulation and supervision of banking. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of banking conform to the standards outlined in the "Core Principles for Effective Banking Supervision" (the "Core Principles") produced by the Basel Committee on Banking Supervision ("Basel Committee"), together with the report by members of the Basel Committee and members of the Offshore Group of Banking Supervisors on the "Supervision of Cross-Border Banking".

The Core Principles comprise 25 basic principles required to be in place for a supervisory system to be effective. The Principles cover:

- preconditions for effective banking supervision (Principle 1);
- licensing and structure (Principles 2 to 5);
- prudential regulations and requirements (Principles 6 to 15);
- methods of ongoing banking supervision (Principles 16 to 20);
- information requirements (Principle 21);
- formal powers of supervisors (Principle 22); and
- cross-border banking (Principles 23 to 25).

The requirements relating to cross-border banking were developed by the report "Supervision of Cross-Border Banking". This detailed the requirements for effective home and host banking supervision in order to facilitate effective consolidated supervision including the associated necessary information flows between regulators.

Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against the above standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

4.2 Type and scale of activity

The ECCB based in St Kitts is responsible for the supervision of commercial and local banks within Montserrat. However, it is not responsible for the "offshore banks". There are currently three banks within the ECCB's jurisdiction in Montserrat, two of which have a physical presence. Total asset size for the domestic section is EC $170m (approximately US$ 63million).

Offshore banks are regulated under the Offshore Banking Ordinance 1991 ("OBO"). The Ordinance was introduced following the banking crisis in the late 1980s when the vast majority of Montserrat's banks had their licences revoked and were closed, primarily because of concerns as to the activities of those banks.

There are currently fifteen offshore banks licensed under the OBO, all of Latin or Central American origin. Six of these banks are subject to consolidated supervision by another regulator. Total asset size of these banks is approximately US$ 1 billion. None of the banks has a physical presence in Montserrat and relevant books and records are not kept on the island. As such they are "cubicle", or as sometimes called, "brass plate" banks. All have a local registered agent and registered address on the island.

According to the FSC one cubicle bank is currently in the process of liquidation.

4.3 Factual assessment

4.3.1 **Legislation**

4.3.1.1 ***Domestic banks***

The legislation underpinning the ECCB is the Eastern Caribbean Central Bank Agreement Act 1983 and its 1993 amendment together with the Uniform Banking Act in place in the various member states. In Montserrat this is the Banking Ordinance (1991).

The ECCB Agreement Act empowers the ECCB to take action to protect the depositors and creditors of financial institutions, including the assumption of control, the acquisition and sale of assets, and the restructuring of financial institutions.

Under the Banking Ordinance Act the Montserrat Minister of Finance is empowered to grant and withdraw licences on the ECCB's recommendations.

4.3.1.2 ***Offshore banks***

The OBO covers a range of issues including:

- application procedure;
- powers and duties of the Financial Secretary;
- powers of the Governor;
- returns required;
- restrictions on business;
- powers of search; and
- minimum capital requirements.

The Ordinance provides for the licensing of offshore banks by the Governor. The Ordinance also provides for supervision and other duties to be performed by the Financial Secretary. These are detailed in 4.3.4.2 below.

4.3.2 **Regulations**

4.3.2.1 ***Domestic banks***

Section 33 of the Banking Ordinance gives the Montserrat Minister of Finance the power to introduce regulations and orders, as may be required from time to time, for giving effect to the provisions of the Ordinance, on the recommendation of the ECCB.

Orders have been issued to extend the provisions of the Ordinance to finance companies and to prescribe the format and minimum information content of published financial statements.

4.3.2.2 ***Offshore banks***

The Governor has powers under the OBO to make regulations, however Montserrat has not yet issued regulations concerning the supervision of offshore banks. Reporting requirements are dealt with under primary legislation. Other matters are dealt with through guidance notes (see below).

4.3.3 **Guidance notes**

4.3.3.1 ***Domestic banks***

The ECCB issues prudential guidelines to domestic banks. These guidelines are designed to promote sound and prudent behaviour in the financial sector. The ECCB places strong reliance on compliance with these Guidance Notes and will take action against those licence holders who fail to comply.

The ECCB has issued prudential guidelines to the banking sector to introduce a number of measures, including the implementation of the recommendations of Basel, where these were not already covered by existing laws and regulations.

Guidelines have also been issued regarding aspects of the operations of financial institutions relating to risk based capital adequacy requirements, large credit exposures, annual loan classification, loan loss provisioning, suspension of interest and write-off procedures.

The ECCB considers the use of guidelines to be effective but can issue them as regulations if necessary.

4.3.3.2 ***Offshore banks***

In the early 1990s the FSC, as the body responsible for day-to-day supervision of the offshore banks, issued guidelines to offshore banks on areas including:

- offshore Bank licensing policy;
- principles relating to the granting of authorisation;
- duties of the authorised and alternative agents;
- prudential requirements;
- financial returns;
- principles relating to ownership;
- principles relating to the revocation of licences and the imposition of contributions;
- preservation of secrecy; and
- principles relating to criminal activities.

The FSC also issued definition notes for the completion of the required returns.

4.3.4 **Supervision - systems and procedures**

4.3.4.1 ***Domestic banks***

All banks licensed by the ECCB are required to maintain a minimum capital level of EC$5 million (approximately US$1.9 million) together with a reserve requirement of 5% of deposit / specified liabilities.

Off-site supervision

On a weekly basis a review of the reserve position is undertaken and on a monthly basis certain specified forms including a balance sheet are required to be submitted electronically. In the case of a branch, the balance sheet of the branch, that of the operations within the ECCB region as a whole, and that of the company of which the branch forms a part, are all required to be submitted. On a quarterly basis, forms covering such matters as delinquency, large credit and deposit exposures, profit and loss and provisioning are submitted. In addition, the annual audited financial statements are submitted.

In undertaking its risk assessment the ECCB uses the Basel capital adequacy model as amended by the Caribbean Group of Banking Supervisors. In general, its risk assessment is based upon the American standard within which the main risks assessed are credit and investment risks.

On-site inspection

The ECCB conducts on-site reviews on a regular basis of all banks for which it has responsibility. It also exercises a risk based assessment to prioritise certain banks. Prior to each visit a pre-questionnaire is submitted by ECCB to the relevant bank. This document is structured in a similar manner to the UK's "CAMEL" regime such that banks are evaluated with respect to Capital adequacy, Asset quality, Management, Earnings and Liquidity.

Following an on-site inspection by the ECCB, banks are either assessed as having no issues requiring further action, or are required to provide a letter of commitment under which the bank agrees to undertake certain corrections, or potentially, an MOU is issued requiring that the bank corrects certain matters within a specified time.

On-site supervision is generally undertaken by at least 5 persons and takes 2-3 weeks. In undertaking the on-site supervision staff are guided by the Manual of Operations which is based on the US Federal Reserve Manual. The ECCB manual is

currently being updated.

The ECCB also holds prudential meetings with the management of the banks. These meetings cover the performance of the subject institution, management strategy, and other pertinent areas.

The ECCB also has quarterly meetings collectively with all the domestic banks in Montserrat.

4.3.4.2 ***Offshore banks***

Regulatory structure

The Governor has overall responsibility for the licensing supervision of offshore banks. Day-to-day supervision of banks is the responsibility of the Financial Secretary. This has been delegated to the FSC.

Under the Offshore Banking Ordinance, the duties of the Financial Secretary include the following:

- monitoring and general review of banking practice in Montserrat;
- processing of licence applications for offshore banks; and
- examination of regular and other returns from licenceholders.

The FSC developed a number of procedures for licensing and monitoring returns. Prior to the volcanic eruptions the regulator comprised three staff led by a banker who had more than 20 years' experience of the banking industry. There is now a single person in Montserrat with full-time responsibility for regulation. Assistance is being provided by the Director of the Financial Services Department in Anguilla under a short-term contract as agreed by the Department for International Development ("DFID").

Licensing

Whilst there is no formal "fit and proper" test established in the OBO, section 5(1) states that the Governor may refuse a licence if he considers that it would be undesirable in the public interest for the licence to be granted.

In addition published guidance notes state that a bank will only be considered for licensing if the following criteria are met:

- it is a branch or subsidiary of a bank with a well-established and proven track record and which is subject to effective consolidated supervision by its home supervisory authority; or
- it is a bank, which, although not a subsidiary, is closely associated with an overseas bank and which, by agreement, will be included within the consolidated supervision exercised by the overseas bank's home supervisory authority; or
- it is a wholly owned subsidiary of an acceptable non-bank corporation whose shares are quoted on a recognised stock exchange, where the objective of the subsidiary is to undertake in-house treasury operations only, and where the operations are fully consolidated in the published financial statements of the parent company.

Banks must also demonstrate "mind and management" in the jurisdiction of incorporation unless they are a subsidiary, in which case the "mind and management" are located in the jurisdiction where consolidated supervision is undertaken.

Applicants who meet the guidelines may apply for a licence. No recent applications have been accepted as they have not met the guidelines. An informal arrangement is in place under which the ECCB will assist in the analysis of applications.

Under the OBO an applicant must have a paid up share capital of at least US$ 500,000 and capital and reserves of at least US$ 500,000. Furthermore, each licensee must maintain a reserve fund, being an amount equal to 25% of its cumulative profits before dividend up to an amount equal to the issued share capital of the licensee.

Off-site supervision

As a result of the volcanic eruptions, the supervisory structure which existed has been severely curtailed, particularly as regards resources and record keeping. Supervision now focuses on the analysis of quarterly financial returns and annual audited returns. Quarterly returns are assessed for compliance with guidance notes and trend analysis is undertaken using a computer based analytical programme.

We have been advised that subsequent to our on-site visit detailed off-site supervisory procedures have been developed and that off-site supervision is now being carried out.

On-site inspection

At the time of our visits, no formal on-site supervision had been undertaken since 1994. However, the FSC had visited those Montserrat-registered banks which were operating from South America and held discussions on the nature of the operations. Visits were also made to the appropriate central bank and banking regulator to review home state supervision.

We are informed that visits were made to all Central American banks in August 2000, including a visit to the appropriate banking regulator to review home state supervision. This leaves only one offshore bank which has not yet been the subject of a visit.

4.3.5 **Enforcement - systems and procedures**

4.3.5.1 ***Domestic banks***

The ECCB has introduced a hierarchy of remedial actions. These may take the form of the following:

- commitment letters;
- memoranda of understanding;
- formal agreements (including cease and desist orders);
- capital directives; and
- removal (or suspension) of a licence.

4.3.5.2 ***Offshore banks***

Where a licence holder has either contravened a provision of the OBO; failed to comply with a condition of its licence; is carrying on its business in a manner detrimental to the public interest; or is unable to meet its obligations, the Governor has a wide range of enforcement powers available. These include:

- revocation of licence;
- imposition of new or additional conditions;
- substitution of a director or officer;
- appointment of a person to advise the licence holder;
- appointment of a person to assume control of the licence holder's affairs; and
- requiring the licence holder to take appropriate action.

The Governor also has the power (under section 12(4) of OBO) to petition the courts to wind up a licence holder.

4.3.6 **Depositor protection schemes**

No depositor protection scheme is currently operating or intended.

4.4 **Issues and recommendations**

4.4.1 **Introduction**

Domestic banks

The remit of our review does not include a detailed analysis of the ECCB as this body does not come within the jurisdiction of Montserrat. Our review has therefore comprised consideration of the relevant legislation as provided to us and discussions with the ECCB. We have not independently verified the accuracy of the information provided to us.

In respect of the Basel core principles, the ECCB has advised that amendments are required to its current banking ordinances

to ensure full compliance. In particular, the ECCB should ensure it has ceased and desist powers and is also able to exchange information, as currently it has no authority to share information with other regulators.

The ECCB does not consider this inability to share information as a particular problem given that no locally incorporated banks have business outside the region. Branches of international banks are however licensed by the ECCB.

The proposed areas for consideration in the revision to the Banking Ordinance are:

- supervision on a consolidated basis by expanding the authority of the ECCB;
- introducing cease and desist orders where institutions fail to meet prudential standards;
- improving information exchange with other regulators;
- expanding the authority regarding controlling shares in an institution;
- improving capital adequacy requirements;
- restrictions on certain activities particularly regarding large credit exposures; and
- the removal and resignation of auditors.

The ECCB is hopeful that a change in the law will be in place by the end of December 2000. It has developed a model amendment but this is currently at a departmental level within ECCB and was not available for general comment at the time of our review.

It is important that the necessary amendments to bring the banking legislation in line with Basel standards are made as swiftly as possible and that the necessary changes to Montserrat legislation are introduced as soon as agreement with the ECCB is reached.

Offshore banks

We agree with the Government and regulator in Montserrat that the level of supervision is not currently sufficient for offshore banks. The limited resources available for regulation and the lack of effective regulation over recent years give significant cause for concern.

The problems are primarily due to the fact that no banking activity is undertaken from Montserrat by the licensed banks and no books or records are maintained on the island, exacerbated by the limited resources available in Montserrat to supervise licence holders.

Of further concern is that, for nine of the 15 offshore banks, Montserrat is the sole supervisor. This appears contrary to the stated licensing policy of the FSC.

Our concern is heightened by the fact that the registered agents for these banks act simply as messengers and post boxes and appear to have little understanding of the activities of the banks for whom they provide registered agent services.

Whilst the efforts to improve the level of regulation by the use of an experienced regulator on a part-time basis is of assistance, and improvements have occurred since his appointment, we agree with the view of the Government and regulator in Montserrat that the current position remains untenable.

It is therefore our view that the current situation cannot be allowed to continue as the risks of depositor loss, criminal activity and reputational damage cannot be assessed under the current level of supervision. Our recommendations to remedy the situation are outlined below.

4.4.2 **Introduction of an effective regulatory regime - alternative 1**

As a matter of immediate priority action should be taken to remedy the current lack of an effective regulatory regime for offshore banking. Whilst we acknowledge that efforts have been made, particularly through the part-time assistance of the Director of Financial Services from Anguilla, these efforts should be significantly increased. The action taken must encompass the following.

4.4.2.1 ***Off-site supervision***

A number of problems were highlighted during our review.

Records of licence holders are inadequate and not up to date. The regulator does not have the full addresses of all directors of its licence holders and therefore cannot undertake "fit and proper" checks. There is also little knowledge of the banks' activities or client base. Attempts are being made to improve the situation, including a visit to Ecuador by the Director of Financial Services in Anguilla (as part of his assistance to Montserrat) to meet representatives from both the Montserrat-licensed and registered banks operating there and the central bank to discuss the issue of consolidated supervision. However no formal on-site inspection of any banks has occurred since 1993 and, in addition, the resources available to perform effective on and off-site supervision are inadequate.

One bank checked during our review has failed to make its 1999 annual return to the Companies Registry, with the result that procedures have started to strike it from the registry.

We have been advised that significant improvement has been made to the off-site programme and the regulatory understanding of licence holders since our on-site visit.

4.4.2.2 ***On-site inspection***

Although we are informed that visits took place in August 2000 to all the Central American banks (in addition to those undertaken in South America which had occurred prior to our on-site work) we have not seen the results of these visits or copies of any procedures employed. It is our understanding that all visits to date have been fact-finding in nature rather than full inspections. We therefore recommend that, in light of information now gathered, a full-scale on-site inspection programme now be carried out.

Such a programme should, if undertaken thoroughly, assist Montserrat in meeting the Basel requirements in the following areas:

- in carrying out an evaluation of a bank's policies, practices and procedures for loans and investments (Principle 7);
- in ensuring that banks have policies, practices and procedures for evaluating the quality of assets and adequacy of loan loss provisions and loan loss reserves (Principle 8);
- in being satisfied that management information systems are in place to identify concentrations. (Principle 9);
- in being satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk, market risk and transfer risk (Principles 11 and 12);
- in ensuring that banks have comprehensive risk management processes in place (including board and senior management oversight) (Principle 13);
- in ensuring that banks have comprehensive adequate internal controls (Principle 14);
- in ensuring that banks have adequate policies, procedures and practices including "know your own customer" (Principle 15).

Whilst elements of the above areas can be achieved through off-site supervision, we consider on-site verification is vital for full compliance to be achieved.

Such a programme should be developed and undertaken as a matter of urgency.

We fully support the interim action currently being taken by the FSC to establish what banks, if any, Montserrat should continue to licence. As part of this a process of wind down of those that will not be permitted to continue must be developed including the use of licence suspension.

4.4.2.3 ***Chalmers Report***

In a Bank of England report on the arrangements for the supervision of banks in Montserrat and one other jurisdiction, issued in 1992 ("the Chalmers Report"), a number of deficiencies were highlighted in the OBO covering important areas such as fitness and probity. A substantial number of these recommendations have not been addressed. This was due in part to the disruption caused by the volcanic eruption.

We therefore recommend that matters raised in the Chalmers Report should be addressed as a matter of priority.

4.4.2.4 ***The Role of the Auditor***

There is currently no provision in the Ordinance granting a gateway for the auditor to disclose information on a licence holder to the Inspector, nor is there an obligation imposed on the auditor to report certain matters or events to the Inspector.

We believe that a duty of reporting, combined with an exemption from the general duty of confidentiality in such reporting, is essential and consequently should be included in a revision to the OBO.

Additionally there should be annual prudential meetings with the auditor and licence holder. We have been informed that one prudential meeting with an auditor has taken place and that others will be carried out as part of the planned on-site inspections referred to above.

4.4.2.5 ***Offshore Banking Ordinance***

In addition to the deficiencies highlighted above, a number of other weaknesses exist in the OBO which include:

- inconsistency with the Exchange of Information Act which appears to restrict the ability to share information relating to the specific clients; and
- the inability of the regulator to obtain client details except via a court order.

Action taken to resolve the weaknesses highlighted above and in the Chalmers Report should be completed as soon as possible. Until such time as the necessary remedial action is completed, we recommend that a moratorium on any further licences for offshore banking activity is instituted.

Legislation should be tightened to ensure that the regulator has the power to close a bank very quickly after the Governor has exercised his powers and that, during any appeal process, the bank's documents can be safeguarded from destruction.

4.4.3 **Introduction of an effective regulatory regime - alternative 2**

In our opinion, in order to achieve the progress required under the alternative outlined above, more regulatory resources will be required. This has been referred to in the previous section of this report. These resources may not be available to Montserrat.

Therefore, as an alternative we would recommend the day-to-day supervision of all licensed banking institutions is undertaken by the ECCB.

As a general principle, we do not consider the division of regulatory responsibility according to the type of bank to be the most efficient and effective use of regulatory resources. We believe that a single banking regulator would be more appropriate as it allows more efficient use of resources for supervision based on risk assessment.

Given the significant difference in resource capability between the ECCB and the local regulator and the ECCB's stated desire to extend its scope to cover cubicle banks, it is our view that the ECCB should assume this role under some form of arrangement. This may require the resolution of any constitutional issues relating to the authority of the Governor in Montserrat. In particular we would be concerned that questions of sovereignty in licensing and similar decisions are properly addressed. This may necessitate the delegation, rather than surrender, of regulatory authority to ECCB. Consideration may be given to delegating the day-to-day supervision of cubicle banks to the ECCB whilst the Governor or other independent licensing body retains the power to grant and revoke licences.

Irrespective of the ultimate arrangement it is important that the ECCB, in extending its regulatory scope to include the cubicle banks, ensures that it takes appropriate cognisance of the difference in role, client base and risks associated with these types of banks and develops its regulatory requirements accordingly.

If regulation is delegated to the ECCB it should be subject to some form of review by the regulator in Montserrat over the discharge of its delegated functions.

4.4.4 **Winding up of the Montserrat offshore banking sector**

If neither of the above approaches are considered acceptable or practical we consider the only remaining alternative would be to wind up the offshore banking sector and to no longer licence cubicle banks.

We welcome your comments on this site.

Prepared 27 October 2000

5 Insurance

5.1 Introduction

The International Association of Insurance Supervisors ("IAIS") has produced a number of principles and standards set out in a series of papers and approved by its members.

These standards recognise that the regulatory framework for insurance supervision varies from country to country, are not mandatory and do not necessarily reflect current practice in all of the member countries. The principles and standards are intended to represent a target for supervisors to work towards and can be implemented in a flexible manner depending upon the circumstances of each jurisdiction.

The Offshore Group of Insurance Supervisors ("OGIS") has also introduced a set of principles, standards and guidance notes upon which self-assessment is required. Conditions of membership of this group include, having legislation in place which enables its regulatory authority to adequately supervise insurance business by having the necessary resources and properly qualified supervisory personnel to enforce the legislation.

Of the territories under review, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of OGIS, with Anguilla having observer status.

The Terms of Reference for this review require us to assess performance against International Standards and good practice in the insurance sector.

It is against these standards that we have made our assessments. The areas where it is considered that development may be required are contained in the issues and recommendations section of this report.

5.2 Type and scale of activity

The scale of insurance activity in Montserrat is extremely limited. We have considered the sector carefully and our comments below reflect this position.

Seven foreign insurance companies are registered to underwrite general insurance in Montserrat. No Montserrat owned or registered company undertakes domestic insurance business. The principal type of business written is motor vehicle and property. Three out of the seven are also authorised to carry on life insurance business.

A regulatory review undertaken at the end of 1999 of IBC names revealed six companies whose names included the word "insurance" in the title. The activities of these companies are currently being investigated by the regulator.

5.3 Factual assessment

5.3.1 Legislation

The main legislation applicable to insurance is the Insurance Ordinance 1977, and minor amendments made to it in 1992 and 1994.

Responsibility for licensing rests with the Director of the FSC who is subject to direction by the Minister of Finance. This does not accord with good practice.

We have been advised that new legislation is to be introduced but we have not had the opportunity to review this.

5.3.2 Rules, regulations and guidance notes

There are no regulations or guidance notes in place relating to insurance business.

5.3.3 Supervision - systems and procedures

There is no ongoing supervision in place covering insurance business. Whilst returns are required these are not reviewed.

Whilst we note that all insurers are external and therefore subject to regulation in their home jurisdiction, we consider that an appropriate level of supervision is required in Montserrat.

Montserrat is in the process of investigating whether those IBC companies using insurance in their name are operating as offshore insurance companies.

5.3.4 **Enforcement - systems and procedures**

There are limited powers of enforcement available in the Insurance Ordinance.

5.3.5 **Policyholder protection scheme**

There is no policyholder protection scheme in place in Montserrat.

5.4 **Issues and recommendations**

5.4.1 **Introduction**

We agree with the Government and the regulator in Montserrat that there is no effective insurance regulation in place. The existing legislation was designed for domestic insurance only and offshore insurance to the extent it exists remains unregulated. We note that all insurers are external and therefore subject to regulation in their home jurisdiction, we consider that an appropriate level of supervision is required in Montserrat.

We further agree that as there are no offshore insurance companies licensed, the existence of six IBCs containing the word "insurance" in their name is of concern for the reasons detailed below.

5.4.2 **Unlicensed activity**

Although an investigation is proceeding it is possible that these companies do not appear to have breached the insurance law as they fall outside the remit of the legislation if they are not writing policies in Montserrat. However, they would appear to be in breach of the Insurance Ordinance 1977 Section 63 anyway. This prohibits the word "insurance" in the name of the company unless authorised.

We support the action being taken to investigate this matter. If these companies are found to be undertaking insurance business, subject to the impact on policy holders and other third parties, action should be taken to stop further insurance business being undertaken by them.

Following this, either:

- the companies should be requested to transfer their business to another, acceptable jurisdiction;
- the assets of the businesses should be put in the care of a trustee; or
- the companies should be wound up.

The precise action required will depend on the nature of the business being undertaken.

5.4.3 Legislation

The current Insurance Ordinance relates only to domestic insurance and is unclear as to whether or not companies carrying on insurance business outside Montserrat need to be licensed.

We therefore recommend that appropriate offshore insurance legislation is put in place together with an appropriate regulatory and supervisory regime. We agree with the FSC's current policy that, until such time as this is in place, no companies incorporated in Montserrat should be permitted to undertake offshore insurance business.

We welcome your comments on this site.

6 Securities/investments

6.1 Introduction

There are established international standards in place concerning the regulation and supervision of those involved in the securities and investments sector. The Terms of Reference for this review requires us to look at whether the arrangement for the regulation of securities and investments conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

The relevant IOSCO Principles for this Section include:

- the responsibilities of the regulator should be clear and objectively stated (Principle 1);
- the regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers (Principle 3);
- the regulator should adopt clear and consistent regulatory processes (Principle 4);
- the regulator should have comprehensive inspection, investigation and surveillance powers (Principle 8);
- the regulator should have comprehensive enforcement powers (Principle 9); and
- the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme (Principle 10).

It is against the IOSCO standards that we have primarily made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations Section below.

For the purpose of this report we have defined Securities/Investment business as covering the following range of activities:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

Legislation and regulation relating to mutual funds is covered in the following section.

6.2 Type and scale of activity

According to the FSC there is currently no identified securities/investment business being undertaken in Montserrat. As a result of this there is currently no legislation covering its regulation.

6.3 Factual assessment

6.3.1 Legislation

There is no legislation in Montserrat covering investment/securities activities, apart from the Exempt Mutual Fund Law which is discussed in the next section to this report. However, the ECCB is currently developing a draft Securities Act (the "draft Act") to accompany the development of the Eastern Caribbean Stock Exchange. It is proposed that this legislation, when finalised, will be introduced by all the ECCB member countries, including Montserrat.

ECCB propose that there will be an East Caribbean Securities Commission ("ECSC"). This will have powers to supervise those engaged in securities business. We have been advised by the FSC that it is not yet clear who will have the power to authorise investment businesses in Montserrat.

We have been advised by the ECCB that the draft Act is not formally based on one piece of legislation but from several countries including Trinidad, Barbados and Jamaica.

6.3.1.1 ***Other legislation***

There is no legislation in place in Montserrat which makes market manipulation a criminal offence. Insider trading is, however, a criminal offence under the Companies Act.

6.3.2 **Regulations and guidance notes**

As there is no current legislation, there are no regulations or guidance notes in place covering investment and securities business.

Under the draft Act, the Montserrat Minister of Finance may, on the recommendation of the ECSC, make regulations prescribing the manner in which licence holders are required to conduct their business.

6.3.3 **Supervision and enforcement - systems and procedures**

As there is no current legislation, no systems or procedures relating to supervision and enforcement are in place covering investment and securities business.

ECCB propose that the ECSC will have the power to impose conditions on a licence and, in certain circumstances, revoke or suspend a licence. It will also be able to issue directions to licence holders, the breach of which will be a criminal offence.

We understand from the ECCB that, whilst the ECSC will be responsible under the legislation, the day-to-day supervision will be conducted by the ECCB.

Furthermore, under the draft Act, the ECSC will have power, in certain circumstances, to appoint an auditor to examine, audit or report on the books, accounts and records of the licence holder and on money, securities or other property held on account of any other person by the licence holder (or his nominee).

There are no proposals within the draft Act for other disciplinary action such as:

- public reprimands ("naming and shaming");
- fining; or
- the declaring of an individual not to be fit and proper.

No final details as to the enforcement systems and procedures have been produced.

6.3.4 **Investor compensation schemes**

No investor protection or compensation schemes are proposed under the draft Act.

6.4 **Issues and recommendations**

6.4.1 **Introduction**

The current absence of investment and securities activity in Montserrat may well change if Montserrat develops its offshore activities. There is therefore a need to introduce investment and securities business legislation to bring Montserrat into compliance with IOSCO principles in this area.

We consider that the most effective way of achieving this is through the introduction of the legislation proposed by the ECCB. Once the draft Act is finalised Montserrat should make its introduction a priority.

6.4.2 **Conflict between draft Securities Act and constitutional position in Montserrat**

The draft Act will encompass both onshore and offshore activity. Accordingly there is a constitutional issue arising since the Governor of Montserrat is responsible under the Montserrat constitution for the international finance sector and its regulation, whilst the draft Act gives the power to the ECSC.

The constitutional position will therefore have to be considered and resolved as matter of priority.

6.4.3 **Draft Securities Act**

An assessment should be made, in advance of the introduction of this legislation, to ensure that the draft Act and regulations made under it are in line with IOSCO Principles.

We welcome your comments on this site.

Prepared 27 October 2000

7 Mutual funds

7.1 Introduction

There are established international standards in place concerning the regulation and supervision of collective investment schemes (known in Montserrat as mutual funds). The Terms of Reference for this review require us to look at whether the arrangements for the monitoring, supervision and regulation of collective investment schemes conform to the standards outlined in the IOSCO paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

Among the IOSCO principles, there are specific principles relating to collective investment schemes. These are:

- that the regulatory system should set standards for the licensing and the regulation of those who wish to market or operate a collective investment scheme (Principle 17);
- the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client money and assets (Principle 18);
- regulation should require full, timely and accurate disclosure of financial results and other information which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme (Principle 19); and
- regulations should ensure that there is a proper and disclosed basis for asset valuation and the pricing and redemption of units in a collective investment scheme (Principle 20).

Other principles, particularly regarding the regulator, enforcement and co-operation also apply to the regulation and supervision of schemes.

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

7.2 Type and scale of activity

Currently Montserrat has an Exempt Mutual Funds Act in place. However there are no funds operating under this Act.

Whilst it is possible that a unit trust structure could be developed (as trusts are not required to be registered), there is no evidence of any mutual funds operating on or from the island and this section should be read in that context.

7.3 Factual assessment

7.3.1 Legislation

The relevant legislation currently in place in Montserrat is the Exempt Mutual Funds Act which requires that no person may establish or administer exempt mutual funds from within Montserrat without a licence. Exempt mutual funds are collective investment schemes that are exempted from taxation by virtue of Part V of the Exempt Mutual Funds Act.

There is no legislation currently in place covering other types of funds.

Under a draft Securities Act (the "draft Act") prepared by the ECCB a legislative and regulatory regime for mutual funds is proposed. This draft Act will apply to Montserrat when it is introduced and the necessary legislation is passed to bring it into effect in the jurisdiction.

The draft Act proposes that the ECSC will be responsible for the approval of the funds. The ECSC is required to inform an applicant of the result of the application within three months of it being submitted.

Whilst regulation will be the formal responsibility of the ECSC, the actual obligation may be delegated by it to the ECCB.

7.3.2 **Regulations and guidance notes**

One regulation has been issued covering mutual funds under the existing Exempt Mutual Funds Act. This covers monthly and annual returns and fees.

The regulation of mutual funds under the draft Act will be governed by clause 72 which provides that the Montserrat Minister of Finance may, on the recommendation of the ECSC, make regulations with regard to areas such as the:

- authorisation of collective investment schemes;
- constitution and management of collective investment schemes, the powers and duties of the manager and custodian of the scheme;
- promotion, marketing and distribution of units;
- the issue and redemption of units;
- provision of management or custodial services; and
- preparation and submission of reports to the ECSC.

A breach of a regulation is actionable by any person who suffers loss as a result of the contravention.

By virtue of clause 113 of the draft Act, the ECSC will have the power to issue guidance notes.

7.3.3 **Supervision and enforcement - systems and procedures**

No systems or procedures relating to supervision and enforcement are in place under the Exempt Mutual Funds Act. The supervisory and enforcement regime under the draft Act has not yet been finalised but we understand day-to-day supervision may be delegated from the ECSC to the ECCB.

7.3.4 **Investor compensation schemes**

There is no scheme in place nor is one proposed under the draft Act.

7.4 **Issues and recommendations**

7.4.1 **Introduction**

As stated above, there is no evidence that Montserrat has any mutual funds in operation. However it may be possible for funds from other jurisdictions to be marketed directly to residents in Montserrat. Therefore, there is a need to remedy the current lack of a full legislative and regulatory framework for funds.

Furthermore, investors in Montserrat may wish to develop this part of its offshore financial service activities in the future.

We consider that a possible method for developing a legislative and regulatory structure would be through the draft Securities Act being developed by the ECCB. There are a number of issues relating to this and these are dealt with below.

7.4.2 **Conflict between laws and constitutional position**

There may be a conflict between Montserrat's existing legislation and the draft Securities Act in the final draft Act creating an overlap between them without appropriate repeal provisions. This potential conflict is complicated by the constitutional responsibility of the Montserrat Governor for the offshore finance sector of the jurisdiction and the mutual funds proposed to be covered by the draft Act which may well include "offshore" funds (i.e. funds that are designed to be sold outside Montserrat).

Montserrat therefore has four choices in relation to the development of legislation in this area:

- if it is possible, the constitutional position of the Governor could be amended with respect to this part of the offshore finance sector and follow the route proposed in the draft Act. This may involve abolishing the Exempt Mutual Funds Act as it is inconsistent with the draft Act;
- it may retain the current constitutional position but delegate the day-to-day supervision to the ECSC, retaining the

Governor's role for the granting and revocation of licences in place. This may also involve abolishing the Exempt Mutual Funds Act;

- it may seek to restrict the funds covered by the draft Act to those which actually will be listed on the new ECSE (discussed in the next section to this Report). Montserrat will then need to develop its own legislation for other funds; and
- Montserrat may wish to consider the route of introducing their own mutual funds law for all schemes if they feel the undertaking of the functions by the ECSC would put them at a competitive disadvantage.

In our view the very limited resources available within Montserrat's regulatory system preclude options three and four at present.

We therefore recommend that consideration is given to pursuing either the first or second options.

7.4.3 **Draft Securities Act**

As stated above, an assessment should be made, in advance of any legislation being introduced, to ensure that the draft Securities Act and regulations made under it are in line with IOSCO Principles.

7.4.4 **Exempt Mutual Funds Act**

Irrespective of the draft Act, we have significant reservations about this law. Whilst it exists, it is not being utilised and there are no structures for supervision in place should it ever be used. Additionally, as mentioned above, it only covers certain type of funds ("an exempt fund") and does not provide a statutory basis for all types of funds.

We recommend that, should it be found to conflict with the draft Securities Act, the Exempt Mutual Funds Act should be abolished when the draft Act comes into force.

If Montserrat wish to retain this category of fund they will need to discuss this matter with the ECCB to assess whether any overlap could be avoided.

We welcome your comments on this site.

Prepared 27 October 2000

8 Stock exchange

8.1 Introduction

There are established international standards in place concerning the regulation and supervision of stock exchanges. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of these exchanges conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

The IOSCO principles which relate to the oversight and regulation of stock exchanges are as follows:

- Self-regulation (principles 6 and 7);
- Issuers (principles 14 to 16);
- Market Intermediaries (principles 21 to 24); and
- The Secondary Market (principles 25 to 30).

The principles for self-regulation address two supervisory relationships. The first of these covers the supervisory activities of the exchange as a self-regulatory organisation ("SRO") and is addressed in this section of the report. The second principle relates to the oversight by the regulator of its SRO and is covered in the section on the regulatory authority.

8.2 Type and scale of activity

There is currently no Stock Exchange in place in Montserrat and consequently no activity. However, as referred to above, an Eastern Caribbean Securities Exchange ("ECSE") is in the process of development and this Exchange will cover Montserrat together with the other seven members of the ECCB.

According to the "Market Structure Blueprint For The Development of the Eastern Caribbean Securities Exchange" prepared in January 2000 by the Financial and Enterprise Development Unit in the Governor's Office of the ECCB, the objective of the ECSE is to develop Eastern Caribbean economies through the creation of alternative sources of capital.

8.3 Factual assessment

8.3.1 Legislation

As referred to earlier, a draft Securities Act has been developed and circulated. Under the draft securities law the ECSE which would be created would be a SRO. The ECSE will establish rules and guidelines which will determine the parameters of operations for all activity taking place within its boundaries. Supervision of the Exchange will be conducted by a new regulator, the Eastern Caribbean Securities Commission ("ECSC"). It is proposed the Exchange will be owned and controlled by the private sector.

8.3.2 Rules, regulations and guidance notes

Given that there is no existing stock exchange there are no regulations or guidance notes.

8.4 Issues and recommendations

The lack of finalised legislation and published regulations in respect of the ECSE precludes a full and effective evaluation of the proposals against international standards and good practice.

As the ECSE is to be private sector owned and controlled and will operate as both a business and an SRO we consider that

strong safeguards will need to be introduced by the ECSC to ensure effective regulatory oversight.

Furthermore whilst it is proposed that regulation will be formally carried out by the ECSC, the actual obligation is likely to be assigned by the Securities Commission to the ECCB.

In our view for this arrangement to meet international standards, the ECCB would need to demonstrate that it has sufficiently trained and experienced resources to fulfil its role. The ECSC will also need the necessary resources to confirm that the ECCB is fulfilling its assigned obligations properly.

We welcome your comments on this site.

Prepared 27 October 2000

9 Companies

9.1 Introduction

As recognised by the TOR, there are no specific international standards concerning the regulation and supervision of companies. However, there are a number of international standards concerning the operation and management of companies. These include the OECD "Principles of Corporate Governance", the G7 "Report on Transparency and Accountability" and the IMF "Guide to Progress in Strengthening the Global Financial Architecture". There is also the work of the International Accounting Standards Committee. Whilst other international standards exist, these primarily relate to particular financial services activities such as banking, securities and insurance and many of their requirements are not directly applicable to ordinary trading and holding companies.

The OECD Principles cover:

- the rights of shareholders;
- the equitable treatment of shareholders;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board of directors.

The Guidance Notes cover the following additional issues with regard to companies:

- the ability of law enforcement and regulatory authorities to identify, quickly and efficiently, the shareholders and directors of a company and the beneficial owners of a company's shares;
- the ready availability of financial information relevant to the activities of companies to law enforcement and regulatory authorities;
- requirements concerning accounting disclosure and auditing practice, particularly where there are obligations to third parties;
- the circumstances in which accounts should be produced and when accounts should be made public;
- the investigative and enforcement powers available to the OT; and
- standards of corporate governance.

The TOR and the Guidance Notes cover companies and company service providers together. However, we consider that it is useful to consider them separately, which we have done in this Report.

We consider that the regulation of company service providers is the most practical and effective way of deterring the abuse of company structures and of ensuring that relevant information is available to law enforcement and regulatory authorities. This approach is in accordance with the views expressed in the recent UK Home Office "Review of

Financial Regulation in the Crown Dependencies" (Section 13.4.1). Nevertheless, there are areas where the requirements imposed upon companies themselves need to be enhanced.

In considering these enhancements, we have not undertaken a review of company or insolvency law as a whole. The TOR do not require us to do this. Instead we have assessed the legislation and regulation of companies in Montserrat against the international standard referred to above and the criteria in the Guidance Notes as summarised above.

9.2 Type and scale of activity

Three types of company may be incorporated in Montserrat: companies incorporated under the Companies Act ("CA

companies"); international business companies ("IBCs"); and limited liability companies ("LLCs").

CA companies are used primarily for domestic purposes and relatively few are incorporated each year.

IBCs are used, and LLCs are intended to be used, as offshore vehicles.

As at 22 May 2000, 97 CA companies and 32 IBCs were on the Register in Montserrat. To date no LLCs have been formed.

No statistical information is available concerning the uses to which CA companies, IBCs or LLCs are put or concerning the main markets for the companies.

9.3 **Factual assessment**

9.3.1 **Legislation**

9.3.1.1 ***Introduction***

There are three relevant pieces of corporate legislation in Montserrat: the Companies Act 1998, the International Business Companies Ordinance 1985 and the Limited Liability Company Act 1998. The legislation is administered by a Registrar of Companies appointed under the Companies Act ("the Registrar").

9.3.1.2 ***Companies Act 1998 ("CA")***

The CA provides for the incorporation, administration and operation of CA companies in Montserrat and ancillary matters such as financial disclosure, insolvency and winding up.

A CA company may be:

- a company limited by shares; or
- a non-profit company.

Subject to any restrictions in its Articles of Incorporation, a CA company may carry on business and hold property both within and outside Montserrat.

A CA company must have a registered office in Montserrat, notice of which must be filed with the Registrar. The address of the registered office of a CA company is a matter of public record at the Registry. A CA company is not required to have a registered agent.

If the shares of a CA Company are or were part of a distribution to the public that company is a public company. A CA company which is not a public company is a private company.

All CA companies are required to prepare comparative financial statements on an annual basis (section 149). The financial statements of a public company or a private company whose gross revenue or assets exceed a certain amount must be audited and filed with the Registrar. A company which is not required to file audited accounts must file a certificate of solvency.

External companies

A company incorporated outside Montserrat which carries on business within Montserrat must register with the Registrar as an external company.

9.3.1.3 ***International Business Company Ordinance 1985 ("IBC Ordinance")***

An IBC is defined as a company which does not:

- own an interest in real property in Montserrat;
- carry on business with persons resident in Montserrat;
- accept banking deposits from persons resident in Montserrat; or
- accept contracts of insurance from persons resident in Montserrat.

The Ordinance excludes from the above definition a number of activities which could be construed as carrying on business

with a person resident in Montserrat but which are ancillary to its main activities.

An IBC may only be incorporated as a company limited by shares.

An IBC must have a registered office and a registered agent in Montserrat. The duties of a registered agent are not set out in the IBC Act. However, only a barrister, solicitor or chartered accountant practising in Montserrat, or a company registered under the Companies Act, which is authorised by its Memorandum to act as a trustee and has an authorised and paid up capital of not less than US$250,000, may act as a registered agent of an IBC.

If it appoints a new registered agent, an IBC must notify the Registrar of the new appointment within 30 days. An IBC is not required to notify the Registry of the resignation of its registered agent.

An IBC is not required to prepare or file financial statements or to have such statements audited.

9.3.1.4 ***Limited Liability Company Act 1998 ("LLC Act")***

The LLC Act provides for the formation of companies with a limited life. The LLC Act is based on the legislation in force in the US State of Delaware.

An LLC has the same rights, powers and privileges as an individual and can carry on any lawful business. An LLC is formed for a limited duration, but there is no maximum duration period.

LLCs are permitted to move domicile.

An LLC must have a registered office, notice of which must be filed with the Registrar, and a registered agent in Montserrat.

LLCs have managers, rather than directors. The manager's responsibilities are specified in the LLC agreement.

There is no requirement for the accounts of an LLC to be audited.

9.3.2 **Regulations, rules and guidance notes**

Regulations prescribing fees payable and forms to be used by CA companies and LLCs were made in 1999.

No regulations have been made regarding IBCs.

No formal guidance notes have been issued in respect of CA companies, IBCs or LLCs.

9.3.3 **Supervision - systems and procedures**

9.3.3.1 ***Regulatory structure***

The Companies Registry has five staff including the Registrar, of whom two are involved on company matters.

The Registrar reports to the Chief Registrar only for the High Court and Supreme Court matters. Overall responsibility for all registry matters is with the Chief Justice.

The Registrar is responsible for maintaining the registers of CA companies, IBCs and LLCs and for registering documents filed. Although some basic checks may be undertaken, this is essentially a recording function.

As the Registrar's role is not a regulatory one, there is little day-to-day supervision of CA companies, IBCs or LLCs apart from statutory returns.

The Registrar's primary supervisory responsibility is ensuring compliance with the requirements of the CA, including ensuring annual returns are filed and the striking off of CA companies.

A register of IBCs is also kept at the FSC.

9.3.4 **Enforcement - systems and procedures**

9.3.4.1 ***Introduction***

There are no enforcement powers in respect of LLCs other than in respect of the payment of fees. In order to keep the Register current, the Registrar must strike off an LLC which has been dissolved, or the term of which has ended, from the

Register of LLCs.

Only the manager or a member can apply to dissolve an LLC.

Both the CA and the IBC Act contain enforcement powers which are described below.

9.3.4.2 ***Inspection***

CA companies

The Court, on the grounds set out in the CA, can appoint an Inspector to examine the affairs of a CA company on application by the requisite number of members.

The Registrar can make enquiries into the ownership of a share or debenture in a CA company.

IBCs

There are no provisions in the IBC Act for the appointment of an inspector of an IBC.

9.3.4.3 ***Striking off***

CA companies

Section 51 of the CA provides that a CA company can be struck off the Register if:

- it fails to send in any returns or to pay a prescribed fee;
- it has been dissolved or amalgamated or its registration has been revoked; or
- it does not change its name when required to do so by the Registrar.

IBCs

The Registrar must strike an IBC off the Register if:

- it fails to satisfy the requirements for an IBC for a period of 30 days or more; or
- it fails to pay its licence fee within the specified time period.

There is no provision to strike off an IBC if it fails to appoint a new registered agent on the resignation or disqualification of its registered agent or if it fails to pay any fines owed.

9.3.4.4 ***Winding up***

The Registrar does not have the power to petition for the winding up of either a CA company or an IBC on the grounds of public interest.

9.3.5 **Public availability of information**

9.3.5.1 ***CA companies***

In respect of CA companies, the documentation held by the Registrar includes the following:

- the articles of incorporation of the company;
- all annual returns filed by the company, which includes a list of the directors, officers and shareholders of the company and either its accounts or the declaration of solvency; and
- any resolutions altering or modifying the Articles of Incorporation.

All information and documentation required to be filed at the Registry is available for public inspection, except the report of an investigator appointed under the Act.

Members of the public are entitled to demand a list of shareholders from a public company.

9.3.5.2 ***IBCs***

In respect of IBCs, the following documentation is held by the Registrar and is available for public inspection:

- the articles of association;
- any other articles, for example of merger, dissolution or continuation; and
- any resolutions concerning an amendment to the articles of association.

9.3.5.3 ***LLCs***

An LLC is formed by filing a certificate of formation. This, and any subsequent amendment, is filed with the Registrar. There are no provisions in the LLC Act which enable the public to inspect documents filed with the Registrar.

However, we have been advised by the FSC that in practice all documents filed with the Registrar would be available for inspection by the public on payment of a prescribed fee.

As no LLCs have yet been formed, we have been unable to confirm this.

9.3.6 **Non-public information**

9.3.6.1 ***CA companies***

The record keeping obligations imposed on a CA company are extensive. The registers and records required to be kept by a CA company include:

- the articles, by-laws and amendments thereto;
- a register of members;
- a register of directors and, in the case of a public company, a register of directors' holdings;
- a register of debenture holders;
- adequate accounting records; and
- minutes of meetings of shareholders and directors.

The directors and shareholders of a company are entitled to access to the register of members and minutes of meetings of members.

The articles, accounting records and minutes of meetings of shareholders and directors are required to be kept at the registered office. There is no requirement for the registers and other records to be kept at any particular location, whether within or outside Montserrat.

9.3.6.2 ***IBCs***

An IBC must maintain the following registers, books and records:

- a share register;
- such accounts and records as the directors consider necessary or desirable to reflect the financial position of the company;
- minutes of meetings of directors and members and committees of directors, officers and members; and
- copies of all resolutions of directors and members and committees of directors, officers and members.

The share register must be kept at the registered office. All other books and records may be kept at such place, within or outside Montserrat, as the directors resolve. Where such a resolution is made there is no requirement for a written record of the location of the books and records to be kept at the registered office.

A member of an IBC has a right in furtherance of a "proper purpose" to inspect the share register and the other records and

documents required to be kept by an IBC. There is no public right to access.

9.3.6.3 ***LLCs***

No record keeping requirements are imposed on an LLC. However, section 24 of the LLC Act provides that a member of an LLC has the right, for any purpose reasonably related to his interest as a member, to be provided with certain information, including:

- information concerning the status of the business and financial condition of the LLC;
- a list of members;
- a copy of the LLC Agreement;
- true and full information regarding the amount of cash and a description and statement of the agreed value of any property or services contributed by each member and which each member has agreed to contribute in the future, and the date on which each became a member; and
- such other information regarding the affairs of the LLC as is just and reasonable.

9.3.7 **Directors**

9.3.7.1 ***CA companies***

Part I, Division D of the CA covers the management of CA companies. This Division contains some provisions concerning the duties and powers of directors.

Section 67 enables the Registrar to make application to the Court for an order that an individual is unfit to be concerned in the management of a public company. Although the section is restricted to public companies, an order made against an individual under this section has the effect of disqualifying that individual from acting as a director of any CA company, although not of an IBC.

9.3.7.2 ***IBCs***

An IBC must have one or more directors, the first of whom is appointed by the subscribers to the memorandum. Corporate directors are permitted. An IBC is not required to maintain a register of directors nor to file details of its directors with the Registrar.

9.3.7.3 ***LLCs***

An LLC may have a manager, but this is optional. If there is no manager the management falls to the members.

9.3.8 **Beneficial ownership**

There is no requirement under the Companies Act or the IBC Ordinance for the beneficial owners of shares in a CA company or an IBC to be notified to the company, the registered agent (in the case of an IBC) or to the Registrar.

The LLC Act does not provide for shares but for "interests". Whilst the LLC does have to file an instrument of formation with the Registrar, including the names and addresses of members, there is no requirement to disclose the beneficial ownership of an interest in an LLC to the LLC or the Registrar.

9.3.9 **Bearer shares**

CA companies may not issue bearer shares, nor is there any provision for bearer share companies under the LLC legislation.

Subject to any limitations in its memorandum or articles of association, an IBC can issue bearer shares.

As there is no requirement for IBCs to file details of its shareholders, it is impossible to ascertain the proportion of IBCs which have issued bearer shares.

9.3.10 **Insolvency**

Part IV of the CA provides for the winding up of CA companies. Section 486 of the CA provides for the making of winding

up rules, however none has been made.

Part IX of the IBC Ordinance details the provisions for the winding up and dissolution of a solvent IBC. An insolvent IBC is wound up in accordance with the provisions of the CA.

There is no provision in the LLC Act enabling the winding up or dissolution of an LLC on the grounds of its insolvency.

9.4 **Issues and recommendations**

9.4.1 **Introduction**

In line with the Guidance Notes we have not undertaken a detailed review of the CA, the IBC Act or the LLC Act. Therefore, our specific comments and recommendations concerning these Acts should not be taken as being the only amendments which may be required. However, we have reviewed those aspects of the legislation which bear directly on our TOR and taken an overview of the legislation for the purposes of comparing it against the OECD principles of Corporate Governance.

From our overview it is clear that the CA, which was enacted in 1998, is a modern and comprehensive piece of legislation containing most of the features which we would expect to find. We are of the opinion that the CA is broadly compliant with the good practice standards set out in the Guidance Notes. However, given that, as stated in the Guidance Notes, a review of company law as a whole is outside the scope of this review, there are specific areas which we have not reviewed but we consider should be subject to a more thorough review. These are referred to in our Report but include:

- the issue of prospectuses; and
- insolvency.

However the IBC Act, which is similar to that found in a number of other jurisdictions, contains a number of deficiencies which are addressed in this report. Consequently, we do not consider that it fully complies with the good practice standards contained in the Guidance Notes. From our overview, it is also apparent to us that the IBC Act should be subjected to a thorough review and our specific recommendations should not be considered to be exhaustive.

The LLC Act is of particular concern. In our view, it falls short of good practice standards and should be subject to a review. We have not specifically referred to LLCs in the evaluation which follows. However, it should be taken that any defects highlighted with regard to the CA and the IBC Acts also apply to the LLC Act.

As no LLCs have yet been formed, we are precluded from reviewing how the LLC Act is operating in practice.

We recommend that no LLCs should be formed until the LLC Act has been brought up to good practice standards.

9.4.2 **Companies**

9.4.2.1 ***Public and publicly traded companies***

The preamble to the OECD Principles states that: "The Principles focus on publicly traded companies". Similarly, we consider that the G22 Report and the IMF Guide are primarily focused on public and publicly traded companies.

Public companies under both the CA and IBC Ordinance can be publicly traded and we consider that, where they are so traded, they should be subject to the OECD Principles, together with the G7 and IMF standards.

There are two views which can be taken of this. The first is that a stock exchange should not list a company from a jurisdiction whose companies legislation fails to meet the Principles. The second is that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework (taking the legislation and case law together) fully meets the Principles and the G7 and IMF standards.

In our opinion, although the first view is undoubtedly correct, a jurisdiction should not rely on exchanges in other jurisdictions to "police" the principles on its behalf. In our view, good practice dictates that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework complies with international standards. We consider that the same standards should apply where the shares of a company can be offered for sale to the public, even if those shares are not publicly traded.

Furthermore, the recommendations of the G22 Working Group on transparency and accountability include a

recommendation that national standards for disclosure should reflect five basic elements: timeliness, completeness, consistency, risk management and audit and control processes.

In the circumstances, we consider that public companies registered under the CA and IBCs which are publicly traded or whose shares may be offered to the public should be subject to a legal framework which meets the Principles.

The CA does contain controls on the issue of prospectuses. For the reasons set out in the introduction, we have not undertaken a full review of the provisions on prospectuses.

The IBC legislation should be amended to make the CA provisions on public companies applicable to those IBCs whose shares may be offered to the public or whose shares are publicly traded.

9.4.2.2 ***Private CA companies and IBCs***

The preamble to the OECD Principles states that the Principles "to the extent that they are deemed applicable might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises".

In respect of IBCs, whose shares may not be issued to the public (which, although there is no distinction between private and public IBCs in the IBC Ordinance, we call "private IBCs") and private CA companies we have assessed those aspects of the Principles which it is reasonable to apply.

We consider that the following sections of the Principles should, in the most part, apply to private CA companies and private IBCs:

- rights of shareholders (section I);
- equitable treatment of shareholders (section II); and
- responsibilities of the Board (section IV).

We consider that both the CA and the IBC Ordinance fall short of the Principles in a number of respects. For example, there are inadequate provisions concerning the protection of minority shareholder interests, potential conflicts of directors' interests (in the CA) and there are no abusive self-dealing provisions.

9.4.3 **Audit**

9.4.3.1 ***Audit of accounts of public and publicly traded companies***

We consider that all public and publicly traded companies should, in line with OECD principles, be required to prepare and submit annual audited accounts.

In the case of both public and publicly traded companies these accounts should be available to the public. This is already a requirement of the CA in respect of public CA companies but is not the case in respect of IBCs. We have been advised by the FSC that there are no publicly traded Montserrat IBCs but it is not clear to us that this is a matter of which the FSC can be certain.

The accounts of public and publicly traded CA companies and IBCs should be prepared in accordance with International Accounting Standards or an equivalent (eg US GAAP). This will require an amendment to the CA and the IBC Ordinance.

9.4.3.2 ***Audit of accounts of private companies***

We do not consider that, unless it is a regulated institution, a private CA company or a private IBC should be required to prepare and submit audited accounts as the cost and burden of such a requirement would outweigh the benefits.

We consider that it is open to the shareholders in a private CA company or a private IBC to require the accounts of the company to be audited. We consider it appropriate that the choice should be the shareholders to make. Similarly it is a matter for potential creditors and others who do business with such companies to determine whether they wish to require an audit as a condition of entering into a business relationship.

9.4.4 **Directors**

We consider that a number of steps need to be taken to facilitate compliance with the OECD principles in this area.

The OECD principles require the responsibilities of directors to be adequately set out. In many jurisdictions this is covered by common law rather than statute.

Provision should be made in International Business Company Ordinance for the disqualification by the Court of directors who are not fit to be involved in the management of a company (such provision exists in the Companies Act). This will reduce the use of so called "nominee" directors as a director can be held accountable for a failure to fulfil his duties. The concept of "nominee" directors is not recognised in the legislation and therefore it is important that effective action can be taken against those who do not exercise their fiduciary duties as directors appropriately. This approach accords with that taken in the "Review of Financial Regulation in the Crown Dependencies" (Section 11.1.4)

There is currently no requirement for an IBC to keep a register of directors or to file details of its directors with the Registrar. We note, however, that Montserrat is giving consideration to introducing such a requirement. In our view every IBC should be required to keep a register of directors and file details of its directors with the Registrar. This approach is in accordance with the OECD Principles of Corporate Governance, Section IV, "disclosure and transparency".

We also consider that the names of directors should form part of the publicly available information held on the companies registry. We are pleased to note that Montserrat is already considering such a requirement.

There is also a need to address the issue of corporate directors. We consider that the use of corporate directors, whilst common in both on and offshore jurisdictions, could lead to a failure to comply with the OECD Principles concerning the responsibilities of the board and, in particular, the key functions of the board, such as reviewing and guiding corporate strategy.

It would, however, be inappropriate to impose a restriction on the use of corporate directors in the OTs until such time as the matter is addressed on a multi-jurisdictional basis. We therefore recommend that corporate directors should continue to be permitted until such time as the issue is addressed internationally. However where corporate directors are provided by a company service provider, the CSP should be required to ensure that the director's duties are being properly fulfilled. This is dealt with in the next section.

In summary, in respect of directors, we recommend:

- that the Registrar should maintain a register of directors of IBCs;
- those who provide directors by way of business should be required to take appropriate steps to ensure those directors are aware of their responsibilities and are suitable for the role; and
- that there should be provision in the IBC Ordinance for a director to be disqualified on the grounds he is not fit to be involved in the management of a company.

9.4.5 **Beneficial ownership**

An effective way to determine beneficial ownership is through a requirement to formally disclosure this to the Registrar. We recognise, however, that this approach is not always practicable. As an alternative we consider good practice is met by requiring company service providers to be licensed and to be obliged to establish and record the beneficial ownership of the companies for whom they provide the service. Our proposals in respect of this are contained in the section on company service providers.

The requirements for establishing beneficial ownership may be met by any client verification requirements which may be contained in Money Laundering Regulations when issued. If so, there must be a link between the companies legislation and the Money Laundering Regulations so that the regulator can enforce the requirements directly. For example, a breach of the Money Laundering Regulations could be grounds for revocation of the licence. Recommendations in relation to this are covered in the section on CSPs.

9.4.6 **Bearer shares**

Bearer shares can provide a significant level of anonymity, which may be abused by those seeking to use companies for a criminal purpose. Furthermore, fictitious bearer shares can be used to perpetrate fraud. There are however legitimate reasons for the use of bearer shares and the issue of bearer shares or share warrants to bearer is permitted in many jurisdictions, including the United Kingdom.

In the circumstances, we do not consider that good practice requires the issue of bearer shares to be prohibited, but they must be controlled effectively to prevent abuse.

This is not an issue with regard to CA companies as they are not permitted to issue bearer shares. IBCs are, however, permitted to issue bearer shares.

In our opinion, the issue of bearer shares in an IBC to an end client is incompatible with good practice as the tracing of beneficial ownership may become impossible.

We therefore recommend that the IBC Act be amended to require the immobilisation of bearer shares as a condition of their issue.

9.4.7 **Registered office**

We consider that every CA company and IBC should be required to keep certain minimum information at its registered office. We consider that this should extend to the statutory registers of members and directors.

In order that the audit trail is not broken, every CA company and IBC should also be required to keep a written record of the location or locations where its other records are kept.

We recommend that, in respect of an IBC, the registered office should only be provided by a licensee under the Company Management Act. Whilst under the CMA, this service can only be provided by a licence holder, there is no parallel requirement in the IBC Ordinance that only a licence holder can be appointed by the IBC to provide this service.

9.4.8 **Insolvency**

The insolvency provisions in the CA are more extensive and modern than those in the legislation of many other jurisdictions. However, as a comprehensive insolvency review did not form part of our TOR, we recommend that a full review be undertaken.

9.4.9 **Enforcement powers**

9.4.9.1 ***CA companies***

We recommend that the following additional enforcement powers should be created:

- the Registrar or the Director of Financial Services should be able to apply to the Court for the winding up of a company on the public interest ground; and
- it should be possible for the Registrar to initiate an investigation of the company by an inspector or, at least, make application to the Court for such an investigation. The power of the Registrar should include the ability to obtain all relevant documents and interview under oath.

9.4.9.2 ***IBCs***

We recommend that the following additional enforcement powers should be created:

- the failure to pay a fine should be grounds for the striking off of a company;
- the Registrar should be able to apply to the Court for the winding up of an IBC on the public interest ground; and
- it should be possible for the Registrar to initiate an investigation of the company by an inspector or, at least, make application to the Court for such an investigation. The power of the Registrar should include the ability to obtain all relevant documents and interview under oath.

9.4.10 **Registered agent**

We consider that only persons licensed under the Company Management Act should be permitted to act as the registered agent of an IBC.

We also consider that the registered agent of an IBC should be required to notify the registry if he ceases to act as registered agent. An IBC which does not have a registered agent should be struck off.

9.4.11 **Company names**

Although the Companies Act gives the Registrar good control of names, Section 13 provides that a company continued into Montserrat may not be required to change its name, even if the name contravenes the provisions of the Companies Act. Additionally new companies are currently permitted to use the same name as companies which are no longer on the register.

We consider this to be unacceptable and the provision should be removed. A company continuing into Montserrat should in this respect be treated as a new incorporation.

We welcome your comments on this site.

Prepared 27 October 2000

10 Company service providers

10.1 Introduction

Company management business typically encompasses a number of activities, including:

- the formation of companies for clients;
- the provision of the registered office for companies;
- the provision of registered agents for companies (in those jurisdictions the legislation of which provides for registered agents);
- the provision of nominee shareholders;
- the provision of director services; and
- the preparation and filing of statutory forms for companies.

In this Report we refer to those who undertake company management business as company service providers ("CSPs").

Most of the OTs have legislation which provides for the regulation of CSPs, although not necessarily covering all the above activities.

There are no international standards concerning the regulation and supervision of CSPs, a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either onshore or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of CSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide company services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed CSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the court to wind up a CSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a CSP's licence, as well as to pursue civil and criminal sanctions;
- CSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the directors of and the shareholders in a company serviced by a CSP and the beneficial owners of the shares in such a company; and
- CSPs, when providing director services, should be required to fulfil their responsibilities as directors and should not be permitted to abrogate their responsibilities through, for example, the use of general powers of attorney.

As indicated in the section on companies, the most practical and effective way of deterring the abuse of company structures and ensuring that relevant information is available to law enforcement authorities is through the regulation of CSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of CSPs in Montserrat and our recommendations concerning enhancements are set out below.

10.2 Type and scale of activity

There appear to be only three businesses providing company management services in Montserrat. All are local law firms. Whilst legislation covering this activity has been enacted, namely the Company Management Act 1998 ("CMA") this legislation was not being enforced at the time of our visit. No licences under the CMA have been issued however, subsequent to our visit, we understand that the three law firms were required to submit applications by the end of July 2000.

Therefore, those carrying on company management business in Montserrat appear not to be in compliance with the CMA and were not subject to regulation at the time of our visit. It should be noted however that there is very little new company management business being undertaken due to the low activity in the company formation sector.

10.3 **Factual assessment**

10.3.1 **Legislation**

The only legislation relating to the regulation of CSPs is the CMA which came into force in 1999. This provides for the compulsory licensing of those engaged in the business of company management and their supervision by an Inspector of Company Managers ("Inspector") appointed under the CMA.

For the purposes of the CMA, "company management" means:

- the registration of companies;
- the provision of registered agent services;
- the provision of registered office services;
- the provision of directors or officers; and
- the provision of nominee shareholders.

Additionally under the IBC Ordinance all IBCs must have a registered agent. Under this Ordinance only barristers, solicitors or chartered accountants practising in Montserrat or a local company having a paid up capital of not less than EC$ 250,000 may act as a registered agent.

10.3.2 **Regulations, rules and guidance notes**

The Governor may make regulations under the CMA. One regulation, covering fees, has been issued.

No guidance notes have been issued in respect of CSPs.

10.3.3 **Supervision - systems and procedures**

10.3.3.1 ***Regulatory structure***

The Governor has responsibility under the CMA for licensing and enforcement matters.

Day-to-day supervision of licensees under the CMA vests in the Inspector. However, as indicated there are currently no CMA licensees. The Inspector is the assistant secretary responsible for the FSC.

10.3.3.2 ***Application process***

Applications for licensing are made to the Governor.

The Governor may grant a licence if he is satisfied that an application is not contrary to the public interest and that the applicant is qualified to carry on the business of company management.

Under the CMA licence holders must have paid up share capital of at least EC$65,000 (however, the minimum requirement under the IBC Ordinance is EC$250,000). Supervision is undertaken by the Inspector of Company Managers who is appointed by the Governor.

No application for a licence has yet been made.

10.3.3.3 ***Supervision***

There is no ongoing supervision of this area as there are currently no licence holders.

Whilst the Inspector has the power to require information and to undertake both on and off-site monitoring, there is no power to review client files without a Court order. There is no power for the Inspector to "police the perimeter" by taking action against non-licence holders undertaking licensable activities.

Licence holders are required to submit audited accounts on an annual basis. They are also required to maintain a policy of professional indemnity insurance.

The Inspector may issue directions in relation to such matters as he thinks fit.

10.3.4 **Enforcement - systems and procedures**

The Governor has a number of enforcement powers including the issuance of directions and the revocation and suspension of licences.

10.4 **Issues and recommendations**

10.4.1 **Introduction**

Although legislation concerning the regulation of CSPs has been enacted, it was not being enforced at the time of our on-site visit. We have subsequently been advised that enforcement has now commenced (see 10.2 above). Nevertheless until this process is in full effect Montserrat fails to comply with the international and good practice standards outlined in the Guidance Notes.

The CMA provides the legal framework for the regulation of CSPs, although some enhancements are necessary. These are detailed below.

10.4.2 **Unlicensed activities**

We were concerned at the time of our visit that although legislation for the regulations of company managers was in place and licensable activities were being undertaken no licences has been applied for.

We therefore support the steps now being taken to enforce the Act by requiring those who undertake company management to apply to become licensed.

10.4.2.1 ***Company Management Act***

The CMA must be amended to bring it into line with good practice.

Amendments include:

- making the Code of Practice enforceable, for example by making a breach of it grounds for disciplinary action including, where appropriate the revocation of a licence;
- the Section in the CMA prohibiting the Inspector access to client files without a court order should be removed as effective on-site supervision cannot take place without such access;
- the current gateways for co-operating with other regulators are too narrow as they do not permit the sharing of information with other regulators. Appropriate gateways for co-operation in line with the EIA should be included;
- there needs to be a power enabling a breach of any anti-money laundering code issued to be grounds for the revocation of a licence;

The Regulator's enforcement powers require to be expanded as outlined at 10.4.4 below.

10.4.3 **Regulatory supervision**

10.4.3.1 ***Licensing process***

We consider that the CMA does not make sufficient provision with regard to the application process. The only conditions which the CMA requires an applicant to meet are that the applicant is qualified to carry on company management business, (ie that they have solid practicable experience in company management), that the application is not against the public interest

and that, in the case of a company, its paid up share capital is at least EC$65,000 (however, the minimum requirement under the IBC Ordinance is EC$250,000).

We note, for example that there is no requirement that the applicant, shareholders, beneficial owners, directors and managers meet the "fit and proper" criteria. The term "qualified" is, on its own, too general and the requirement that the applicant demonstrate solid and practical experience in company management; whilst a positive requirement does not fully create a statutory fit and proper requirement.

There is no evidence that the Inspector would not apply a fit and proper criteria, but in our view the legislation should provide the Inspector with legal authority to do so.

Although we do not consider that "four eyes" control should be an automatic requirement for every CSP, we consider that in the majority of cases it will be appropriate. We recommend, therefore, that as part of the review process for an application, the Inspector should consider whether the business proposed to be undertaken by the applicant justifies the imposition of a requirement that at least two people will be involved in the operation of the CSP to provide support and oversight. Where a licence is granted to a CSP without requiring "four eyes" control, the Inspector should keep the situation under review as it may subsequently become appropriate for him to impose such a requirement.

10.4.3.2 ***Code of Practice***

To facilitate the meeting of the international and good practice standards identified in the Guidance Notes, once the CMA is being enforced, we consider that all CSPs should be subject to an enforceable Code of Practice. The Code of Practice should include requirements relating to:

- the maintenance of the records in the jurisdiction;
- knowing the beneficial owner of a company on an ongoing basis;
- the suitability of directors provided by the licence holder;
- the mechanisms for ensuring the immobility of bearer shares;
- the provision of powers of attorney;
- the conduct of directors provided by licence holders;
- the segregation of client money and assets; and
- the provision of signing authorities to other persons, including shareholders and the beneficial owners of shares, to a bank account of a company where the licence holder provides director services.

The anti-money laundering regulations, when issued, should apply to CSPs. To the extent that the anti-money laundering regulations cover matters listed above, the Code may simply make adherence to those regulations, and any guidelines issued under them, a requirement under the Code of Practice so providing enforcement powers for the regulator even if no criminal action is taken as a result of the breach.

10.4.3.3 ***Ongoing supervision***

Off-site

The CMA does provide for the filing of audited accounts. We consider that the CMA should be amended to require the filing of regular compliance returns from the licence holder providing details of licensees' activities and their confirmation of adherence to the Code of Practice.

On-site

Once the Code of Practice is in place, a programme of on-site inspections should be commenced. This programme should also cover compliance with any anti-money laundering code in place and the development of an on-site procedures manual. We recommend that the initial phase of on-site inspections should be completed by 31 March 2001.

As indicated, the CMA restricts the ability of the Inspector to access client information and files. We consider that it will not be possible for the Inspector to carry out effective off-site supervision unless these restrictions are removed.

10.4.4 **Enforcement of regulations**

The Inspector rather than the Governor should have the power, himself, to take disciplinary action.

In addition to his current powers he should have access to ultimate regulatory sanctions such as the express ability to:

- apply to the Court, where necessary, for injunctive or other reliefs to protect the clients of a licensed or formerly licensed CSP; and
- to petition the Court for the winding up of a licence holder in the public interest.

This will enable the Inspector to both detect and deter abuse and take appropriate action where it is discovered.

10.4.5 **Insurance**

We recommend that a requirement for professional indemnity insurance, as provided for under Section 20 of the CMA, is enforced.

Licence holders who are required to effect insurance cover should be required to satisfy the Inspector that the appropriate policies are in place on an annual basis.

In addition we recommend that the Inspector considers whether licence holders who have control of client funds should also effect fidelity insurance.

10.4.6 **Bearer shares**

The issue of bearer shares to end clients, without any control being exercised, is contrary to good practice as it is difficult, if not impossible, to ascertain the beneficial owner of the company at any given time.

Whilst we are not persuaded that international practice and standards require the outright prohibition of bearer shares, we consider that their use should be strictly controlled. The appropriate method of achieving this is to regulate their issue by amendment to the IBC Ordinance. We therefore consider that the IBC Ordinance should be modified to require that bearer shares may only be issued if they are immobilised. This is dealt with in the companies section.

The immobilised bearer share must either be retained by the licence holder or by someone acting on his authority. Thus the true owner could be ascertained with appropriate legislation. The details of the requirement should be contained in the Code of Practice.

If this cannot be achieved, consideration should be given to prohibiting the use of bearer shares.

We welcome your comments on this site.

Prepared 27 October 2000

11 Partnerships

11.1 Introduction

The legislation in all of the OTs provides for two different types of partnership, ordinary or general partnerships and limited partnerships. None of the OTs have legislation in place that provides for the formation of limited liability partnerships, ie partnerships which are separate legal entities where, unlike limited partnerships, the limited partners are permitted to take part in the management of the business (which are primarily used as vehicles for professional firms).

11.1.1 Ordinary partnerships

The ordinary partnership legislation of those OTs that have it is based upon the UK Partnership Act 1890. Neither the UK Partnership Act nor the OT partnership legislation establishes supervisory regimes. The legislation typically sets out the rules for determining the existence of a partnership and governs, to a limited extent, the relationship between partners and between the partnership and third parties. Ordinary partnerships are not subject to registration in any of the OTs. The liability of all partners in an ordinary partnership is unlimited.

Ordinary partnerships are formed almost exclusively by domestic businesses in the OTs usually where the business is small or where the members of a particular profession are prohibited from carrying on business through a limited liability company.

As ordinary partnerships are not generally used for offshore purposes we do not consider that they fall within our TOR and we have not covered them in our review. In so far as ordinary partnerships, such as lawyers and accountants, also act as company or trust service providers, their role is dealt with in those sections of this Report.

11.1.2 Limited partnerships

Limited partnerships enable the liabilities of "sleeping partners" to be limited to their capital contribution provided that they do not take part in the management of the partnership. They are used typically in investment schemes to limit the liability of investors without giving them ownership of a share in a company. They are also used in estate planning schemes.

The TOR and the Guidance Notes require us to determine whether the legislation, framework and systems in place in each OT conform to good practice having regard, in particular, to FATF and CFATF Recommendations, the OECD Principles of Corporate Governance ("the OECD Principles") and the G22 Report on Transparency and Accountability.

There are no international standards that relate specifically to the supervision of limited partnerships. We have therefore considered the appropriateness of the above general standards for limited partnerships. It is our view that:

- the FATF and CFATF Recommendations that are of primary relevance to limited partnerships are those that concern "know your customer" and record keeping procedures;
- the OECD Principles are designed primarily for publicly traded corporations and are not appropriate to limited partnerships; and
- the G22 Report on Transparency and Accountability is not applicable to limited partnerships.

Due to the limited liability given to limited partners, limited partnerships are attractive offshore vehicles and, in common with all offshore vehicles, are subject to potential abuse by money launderers and other criminals. We therefore consider that good practice requires that, in the event that a limited partnership is suspected of being involved in criminal activity, the law enforcement authorities should be able to access information concerning both the limited and general partners. This approach was envisaged by the Guidance Notes.

We also consider that the business of:

- forming limited partnerships; and
- providing a registered office for limited partnerships;

should be regarded as financial services. As such, it is important that high standards are maintained for the protection of clients. Subject to special circumstances, we consider that good practice standards require that these activities should be regulated.

11.2 Type and scale of activity

There are two types of partnership provided for under Montserrat law; general partnerships and limited partnerships.

As at 31 May 2000 no limited partnerships had been registered in Montserrat. However, for the sake of completeness and in anticipation of there being limited partnerships in Montserrat in the future, we have considered the current regime below.

11.3 Factual assessment

11.3.1 Legislation

Montserrat has two pieces of legislation concerning partnerships. These are:

- the Partnership Act 1998; and
- the Limited Partnership Act 1998.

11.3.1.1 *The Partnership Act*

For the reasons set out in the Introduction, we have not considered the Partnership Act in this Review.

11.3.1.2 *The Limited Partnership Act ("LPA")*

The LPA permits the formation and their registration by the Registrar of Companies ("the Registrar"). Limited partnerships consist of one or more general partners and one or more limited partners. The provisions are similar to the limited partnership legislation found in the US State of Delaware. The Partnership Act also applies to limited partnerships except where it is inconsistent with the LPA in which cases the LPA prevailing.

The general partners carry on the business of the partnership and have the same liabilities and responsibilities as partners in a general partnership. Limited partners contribute or undertake to contribute capital to the partnership and their liability is limited to the capital that they have contributed or undertaken to contribute. To the extent that a limited partner participates in the control of a limited partnership, he is liable as a general partner to persons who transact business with the limited partnership reasonably believing that he is a general partner.

A limited partnership must have a registered office in Montserrat but it is not required to have a registered agent.

11.3.2 Regulations, rules and guidance notes

There are no rules, regulations or guidance notes in place concerning partnerships.

11.3.3 The formation and registration of limited partnerships

Persons who carry on the business of forming limited partnerships or providing the registered office for limited partnerships are not, in that capacity, currently regulated. We do not know whether such persons are intended to be subject to the Anti-Money Laundering Regulations that we are advised have been drafted.

Limited partnerships must be registered with the Registrar of Companies. Registration involves filing a statement with the Registrar signed by or on behalf of the general partner and containing basic information concerning the partnership and its partners.

Until a partnership is registered as a limited partnership, the partners will not obtain the benefit of limited liability.

11.3.4 Supervision - systems and procedures

11.3.4.1 *Regulatory structure*

Details of the structure and resources of the Registrar and Companies Registry are provided in the section of this Report on Companies.

11.3.4.2 ***On-going supervision***

In common with other jurisdictions, there is no on-going supervision of limited partnerships.

11.3.5 **Enforcement - systems and procedures**

There are currently no specific enforcement procedures available in respect of general or limited partnerships, although certain breaches of the LPO are offences that are punishable by a fine.

11.3.6 **Publicly available information**

11.3.6.1 ***Information held by the Registrar***

The information contained in the register of limited partnerships maintained by the Registrar covers the following:

- the general nature of the firm's business;
- the address of the registered office of the limited partnership in Montserrat;
- the full names and addresses of the general partners (specifying them as general partners); and
- the term, if any, of the limited partnership.

A limited partnership is required to inform to the Registrar of changes in any of the above details.

Limited partnerships are also required to make annual returns to the Registrar. The return must confirm whether there have been any changes to the information supplied to the Registrar at registration.

The register of limited partnerships in which each statement is registered, is open to public inspection.

11.3.6.2 ***Information held at the registered office***

The general partners of a limited partnership must keep a register containing:

- the name and address of each partner; and
- the amount and dates of contributions of each partner; and
- the amount and date of any payment representing a return of any part of a partner's contribution

at the registered office of the partnership.

The register of limited partnership interest is open to public inspection.

11.3.7 **Non-public information**

There are no requirements that a limited partnership keep any accounting or any other books or records.

11.4 **Issues and recommendations**

11.4.1 **Introduction**

In accordance with our interpretation of our TOR, we are required to assess whether:

- in the event that a limited partnership is used or suspected of being used for criminal purposes, the law enforcement authorities in Montserrat are able to obtain basic information concerning the partnership, such as the identity of the general and limited partners;
- the identity of general and limited partners of limited partnerships in Montserrat has been ascertained through the usual "know your customer" procedures; and
- adequate procedures are in place to protect the interests of partnerships utilising professional service providers in Montserrat.

For the reasons set out in the following paragraphs we are of the view that Montserrat meets in some respects the good practice standards set out in the Guidance Notes but it does not meet all of them.

Our recommendations follow.

11.4.1.1 ***Availability of information to law enforcement authorities***

The information required to be filed with the Registrar is set out in paragraph 10.3.6.1 above. This includes basic information, but it does not include details of the limited partners and their capital contributions.

The information filed is available to the public and therefore readily accessible to the law enforcement authorities in Montserrat.

We do not consider that good practice requires that information concerning the limited partners and their capital contributions should be filed at the Registry provided that the information is available in Montserrat.

The LPA requires the general partners to keep a register of limited partnership interests containing the above information which is available for public inspection.

We do not consider that it is necessary for the records to be available to the public but, subject to Court Order, they could be accessed by the law enforcement agencies if required.

We are of the opinion that the legislative requirements prescribing the information and records to be kept in Montserrat meet good practice standards. Of course the quality of the information will be dependent upon:

- the due diligence checks undertaken with regard to partners; and
- the degree of compliance with regard to the other record keeping requirements.

11.4.1.2 ***Application of know your customer and record keeping requirements***

In order to comply with FATF and CFATF recommendations, we consider that persons who provide the service of forming limited partnerships and those who provide registered office for limited partnerships should be subject to the usual "know your customer" and record keeping requirements.

This is not currently the case and Montserrat does not therefore comply with good practice standards.

We therefore recommend that the Anti-Money Laundering Regulations, when issued (as discussed later in this report), should cover any person who, as part of their business:

- forms limited partnerships; or
- provides the registered office of limited partnerships.

We consider that the LPA should be amended to provide that only licensees can form limited partnerships for profit.

11.4.1.3 ***Regulation of professional service providers***

We are of the opinion that persons who form limited partnerships or provide registered office services for limited partnerships should be considered as financial service providers and subject to regulation. The objectives of regulation are as follows:

- the maintenance of standards generally that will protect partnerships using the service providers; and
- the maintenance of high record keeping standards so that records required to be kept at the registered office are maintained in good form so that they are of value to the law enforcement agencies if required.

We therefore recommend that only licensed company managers or trust companies are permitted to:

- form limited partnerships; or
- provide the registered office of limited partnerships.

Some jurisdictions provide for the appointment of a registered agent. We consider that this is desirable and recommend that limited partnerships should be required to appoint a registered agent.

Registered agents should be licensed company managers or trust companies and should be subject to Anti-Money Laundering Regulations when made.

11.4.1.4 ***Other areas for improvement***

The Registrar currently has no enforcement powers with respect to limited partnerships. We consider that this does not comply with good practice standards.

We consider that the Registrar should be able to apply to the Court for the dissolution of a limited partnership and/or for the appointment of an inspector in appropriate circumstances. The grounds could include fraud, insolvency or other public interest grounds.

We see procedures for the appointment of an inspector as analogous to the appointment of an inspector under the Companies Ordinance.

We recommend that it should be an offence to provide the registered office of a limited partnership by way of business when not holding a licence.

Finally there is no requirement that a limited partnership maintain accounting records. We consider that there should be. We recommend that all limited partnerships should, as a minimum, be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership.

We do not consider that these records need to be kept within the jurisdiction provided that there is a written record of the location where the records are kept at the registered office of the limited partnership. This will ensure that in the event of a criminal investigation the audit trail is not broken.

We welcome your comments on this site.

Prepared 27 October 2000

12 Trusts

12.1 Introduction

Trusts are commonly used in offshore structures. They typically involve settlors, trustees and beneficiaries and often involve protectors, enforcers and custodians.

The settlor of a trust [2] is the person who transfers ownership of his 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.

The trustees of a trust hold legal title to the trust property. They must keep trust property separate from their own property. 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 invite and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes.

All trusts (other than purpose trusts) must have beneficiaries who may include the settlor. The trustees must account to the beneficiaries for what they do with the trust property. The beneficiaries are entitled to enforce implementation of the trust deed. A trust may be settled without existing beneficiaries provided that a beneficiary is or beneficiaries are ultimately ascertainable.

A trust may have a protector who will typically have powers to veto the trustees' proposals or remove them. A purpose trust is a trust for a particular purpose or purposes. Most of the OTs permit charitable and non-charitable purpose trusts.

An enforcer is the person who has the power to enforce a purpose trust.

A custodian trustee holds the trust property to the order of the managing trustee.

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the TOR. The TOR therefore require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries and protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary because a proper consideration of the above issues involves both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the "Review of Financial Regulation in the Crown Dependencies" (Section 12.9.5). Our recommendations concerning professional trust providers in Montserrat are contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of Montserrat are required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not in this Report concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

12.2 Type and scale of activity

There are no requirements for trusts to be registered or reported in Montserrat and there are consequently no statistics available concerning the type and scale of the trust business in Montserrat. It is not, therefore, possible to provide any estimate of the number or the net value of trusts administered in Montserrat. We understand from our discussions with Government and the private sector, however, that activity is very low, possibly non-existent.

12.3 Factual assessment

12.3.1 Legislation

The principal legislation relating to trusts in Montserrat is the Trust Act 1998 ("TA").

The TA makes general provision for trusts in Montserrat and provides for the duties and powers of trustees.

Both charitable and non-charitable purpose trusts are specifically provided for, and permitted, by the TA. In the case of non-charitable purpose trusts, the TA requires:

- that the terms of the trust provide for the appointment of a protector; and
- that at least one trustee is a "designated person" who must maintain a copy of the trust deed and a register of the trust in Montserrat.

A designated person is an accountant, attorney-at-law, a trust corporation, a licensee under the Offshore Banking Ordinance or a person designated by the Governor.

Part VII of the TA (entitled "Foreign Elements Law") provides that a Montserrat trust will not be void or set aside simply because a foreign jurisdiction does not recognise the concept of a trust or because the trust avoids or defeats any rights conferred by a foreign law upon a person by reason of personal relationship or by way of forced heirship. This Part therefore permits the creation of "forced heirship" trusts which are commonly utilised by settlors from jurisdictions where the law requires assets in a deceased's estate to be distributed in accordance with a particular formula. By settling his assets into a forced heirship trust, a settlor attempts to leave his assets according to his or her wishes rather than in accordance with the formula stipulated by the law of his jurisdiction.

A number of other jurisdictions have similar legislation facilitating the creation of forced heirship trusts.

12.3.2 Regulations, rules and guidance notes

There are no regulations, rules or guidance notes in place relating to trusts.

12.3.3 Supervision and enforcement - systems and procedures

Trusts are not registrable in Montserrat and, in common with other jurisdictions, are not subject to regulation by a regulatory authority. There is, therefore, no requirement for trustees, beneficiaries, custodians or protectors of Montserrat trusts to be notified to any central authority.

Trustees do, however, have a number of duties imposed on them under the TA and the duties of a trustee under English common law would almost certainly be imposed on trustees by the courts in Montserrat.

12.4 Issues and recommendations

12.4.1 Introduction

Trust legislation in Montserrat is similar to the trust legislation in a number of other jurisdictions, including England. In general, we do not consider that there are any particular features of the TA that are likely to lead to trust structures in Montserrat being any more or less attractive to criminals or money launderers than trusts in other jurisdictions.

12.4.2 **Preventing the abuse of trusts**

As indicated in the Introduction to this section, we consider that the most practical and effective way to prevent the abuse of trusts is through the regulation of trust service providers. We consider that all persons providing trust services should be regulated. Our recommendations concerning this are set out in the next section. We do not consider that any changes to the TA are required to support this.

We are concerned, however, that the use of purpose trusts may be open to abuse. Purpose trusts have no beneficiaries to take action against trustees who are in breach of their duties and there is therefore a possibility of abuse by the trustees.

We note that under the TA, however, non-charitable purpose trusts are permitted only where a protector is appointed. This will reduce the risk of abuse as the activities of the trustee will be supervised by the protector and the opportunity for misuse of trust assets by the trustees will be limited. This is further supported by the requirement that at least one trustee is a "designated trustee" who must maintain a copy of the trust deed and a register of the trust in Montserrat. We consider that this protection would be enhanced if the TA also required that at least one of the trustees of a purpose trust was a licensed trust service provider. We recommend that the TA should be amended accordingly.

12.4.3 **Establishing the true owner of trust assets**

In general, beneficial ownership of assets held in an express trust may be clear and ascertainable. However, this may not necessarily be the case for a discretionary or purpose trust or where the trustees may exercise discretionary powers.

We consider that, in the case of trusts administered by a professional trust service provider, law enforcement and regulatory authorities must, in appropriate circumstances, be able to identify the settlor, trustees, beneficiaries, protector and custodian and have access to the trust instrument and other relevant documentation concerning the trust.

This requires that the relevant documentation and information is kept within the jurisdiction. In respect of trust service providers, this is covered in the next section. This is not a general trust issue and we do not, therefore, consider that the TA requires any amendment in this respect.

12.4.4 **Anti-money laundering measures**

In our opinion, international standards require that professional trust service providers should be required to put in place effective anti-money laundering measures, including know your customer, record keeping and staff training procedures.

Our recommendations concerning this are set out in the sections of this report on money laundering and trust service providers.

We do not consider that it is appropriate to deal with this matter in the TA as the TA is not supervisory in nature.

12.4.5 **Transparency of financial arrangements**

The Guidance Notes indicate:

- that basic financial information relevant to the activities of trusts should be available to law enforcement and regulatory authorities; and
- that trustees should, ideally, be held accountable to beneficiaries where appropriate, by preparing regular accounts, where appropriate, which might also be available to the settlor and protector, where applicable.

We are further asked to consider in what circumstances it would be appropriate for accounts to be produced, whether accounts should be made public, in which circumstances abbreviated accounts might be acceptable and in which circumstances the requirement to produce accounts should not be applied.

We consider that professional trust service providers should be required to maintain proper financial records and that these should be available for inspection by the protector and beneficiaries (where appropriate). We also consider that these records should be available to law enforcement authorities where required in a criminal investigation. Our recommendations concerning this are contained in the next section of this Report.

However, we do not consider that trust accounts should be made public as they are private arrangements. Furthermore, we consider that requiring the preparation of accounts and their subsequent audit may be regarded by some clients as an

unnecessary cost burden. In our view it should be for the client to determine whether he wishes accounts to be prepared and audited. Whilst we believe that the preparation and, where appropriate, auditing of trust accounts, is of benefit as it reduces the risk of misappropriation of trust assets, it is not the role of legislation to impose it. There is, for example, no requirement in the UK for trust accounts to be prepared or audited, and it is not generally the case anywhere else.

12.4.6 **Removal of impediments to asset tracing and seizure**

This is considered further in the section on money laundering.

There is nothing in the legislation to prevent a so-called "flee" clause being included in a trust deed, the effect of which may be to frustrate the seizure of assets emanating from a criminal source.

We therefore recommend that as flee clauses are an issue of general application, trust legislation should be amended to restrict their use.

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2 The descriptions of settlors, trustees, beneficiaries, protectors, enforcers and custodians are based on those set out in the "Review of Financial Regulation in the Crown Dependencies" which we consider provide excellent summaries. Back

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Prepared 27 October 2000

13 Trust service providers

13.1 Introduction

There are no international standards concerning the regulation and supervision of trust service providers ("TSPs"), a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either on or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of TSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide trust services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed TSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the Court to wind up a TSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a TSP's licence, as well as to pursue civil and criminal sanctions;
- TSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the settlor, beneficiaries, protector and the custodian (where applicable) of a trust and to obtain a copy of the trust instrument;
- law enforcement and regulatory authorities should be able to access financial information relevant to the activities of trusts administered by a TSP; and
- trustees should be held accountable to the beneficiaries and settlor, and the protector, where applicable, by preparing regular accounts, where appropriate.

As indicated in the section on trusts, the most practical and effective way of deterring the abuse of trusts and ensuring that relevant information is available to law enforcement authorities is through the regulation of TSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of TSPs in Montserrat and our recommendations concerning enhancements are set out below.

13.2 Type and scale of activity

The scale of trust activity in Montserrat is extremely limited. We have considered the sector carefully and our comments below reflect this position.

There is no legislation regulating the provision of trust services in Montserrat. The duties of trustees are governed by the Trustee Ordinance 1968 which simply details the duties and obligations of a trustee.

There is only one company incorporated in Montserrat which uses the word "trust" in its name. This was registered under the International Business Company Ordinance. The Financial Services Centre is currently making enquiries through the company's registered agent as to the nature of the company's activities.

13.3 Factual assessment

13.3.1 Legislation

Whilst there is provision for the granting of trust licences under the Offshore Banking Ordinance, this relates to the operation

of trust corporations as defined in the Trustee Ordinance 1968. There is therefore no specific legislation relating to the regulation of trustee service providers.

13.3.2 **Rules, regulations and guidance notes**

There are no rules or regulations or guidance notes in place concerning the provision of trust services beyond that contained in the Trustee Act itself.

13.3.3 **Supervision and enforcement - systems and procedures**

There is no supervision of trust service provision.

There is no enforcement in relation to trust service provision. The only powers of enforcement are those contained in the Trustee Act itself.

13.4 **Issues and recommendations**

The lack of a legislative and regulatory environment for those engaging in trustee services provision is not in line with the Guidance Notes. Whilst the current level of activity is low or possibly nil, legislation is needed as at least one company may be carrying on business as a trust service provider.

There is also a need for a regulatory regime to be established to supervise the activities of trust service providers.

We therefore recommend that legislation and accompanying regulation is brought in to regulate those engaged in trustee service provision.

Given the other matters that need to be addressed in relation to other financial services activity, we recommend that the necessary infrastructure is only given a medium priority.

We welcome your comments on this site.

Prepared 27 October 2000

14 International co-operation

14.1 Introduction

A number of international standards are in place concerning the provision of co-operation between law enforcement and regulatory authorities. These include those established by international regulatory bodies such as IOSCO, IAIS and Basel, the relevant FATF/CFATF Recommendations, the "Ten Key Principles for International Financial Information Exchange" recommended by the G7 Finance Ministers in May 1998 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. These, together with good practice standards, are referred to in the Guidance Notes. We were not asked to consider international co-operation relating to purely fiscal matters but we have considered whether the legislation permits co-operation on criminal tax matters.

The principal international standards and good practice standards set out in the TOR and the Guidance Notes are that:

- there are effective gateways in place through which an OT regulator can disclose confidential information obtainable from licensed bodies, including client information, to foreign regulatory authorities;
- the OT regulator is able, through the imposition of conditions, to require that confidential information it discloses to a foreign regulatory authority is not onward disclosed by the foreign regulatory authority without the consent of the OT regulator;
- an OT regulator is able to safeguard the confidentiality of information disclosed to it by a foreign law enforcement or regulatory authority;
- where necessary, MOUs between an OT regulator and foreign regulatory authorities are in place and that MOUs should contain provisions for safeguarding the confidentiality of information provided;
- the law enforcement authority in an OT has a full range of powers to provide mutual legal assistance to foreign law enforcement authorities, including the obtaining of evidence and the provision of assistance at the investigation stage;
- co-operation between law enforcement authorities should cover all financial crimes (including, for example, fraud, insider trading and market manipulation) and not just drugs related offences or money laundering;
- it should be possible for co-operation to be provided even if the activity under investigation takes place and/or is not a criminal offence in the OT;
- international co-operation should extend to tracing, freezing and confiscating proceeds of crime on behalf of overseas authorities. This should be on an "all crimes" basis (including all financial crimes), as envisaged by the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990;
- no assets should be immune from seizure by virtue of OT laws or through asset protection trusts or flee clauses in trusts;
- law enforcement and regulatory authorities should be able to co-operate effectively with each other both domestically and with their counterparts abroad;
- OT regulators can, in the course of their normal duties, obtain information relating to the supervision of licensees which can be disclosed to foreign regulatory authorities through the statutory gateways;
- OT regulators have powers at least equivalent to those contained in the model "Compulsory Powers Ordinance" annexed to the Guidance Notes to compel the production of information, at the request of foreign regulatory authorities for their own regulatory purposes, from both regulated and unregulated bodies and persons; and
- adequate resources, including legal advice, are available to OT regulatory and law enforcement authorities for the purposes of international co-operation.

The TOR for this review require us to consider whether the legislation and systems and procedures in place in Montserrat for international co-operation conform to the above international and good practice standards.

Areas for development and action are contained in the issues and recommendations section below.

14.2 **Confidentiality**

14.2.1 **Introduction**

Regulators are usually subject to a duty of confidentiality which may be imposed:

- under a general statute which preserves the confidentiality of information with respect to business which is of a professional nature;
- in legislation which creates or governs the regulator;
- in legislation which provides for the regulation of particular financial services; and/or
- under common law.

It is appropriate and in accordance with international standards for restrictions to be placed upon the disclosure of confidential information by a regulator. However, in order for a regulator to effectively co-operate with foreign regulatory and law enforcement authorities, there must be gateways through which he can pass confidential information.

14.2.2 **Relevant legislation in Montserrat**

The preservation of confidential information in Montserrat is achieved primarily through the Confidential Information Ordinance, 1985 ("CIO"), which is of general application. In addition, certain duties of confidentiality are imposed at common law and under those statutes which provide for the regulation of financial services.

There are statutory provisions which enable the disclosure of information to law enforcement authorities within and outside Montserrat and to foreign regulatory authorities. These are contained in the Exchange of Information Act, 1999 ("EIA"). The EIA also provides the Director of the FSC with compulsory powers to obtain information from licensees and non-licensees for his own regulatory purposes and at the request of a foreign regulatory authority.

For the purposes of this Report, we have reviewed the CIO, the EIA and the following statutes, all of which contain provisions relating to the preservation of confidentiality and/or to international co-operation generally:

- the Offshore Banking Ordinance 1991 ("OBO");
- the Insurance Ordinance 1977 ("IO");
- the Company Management Act 1998 ("CMA");
- the Mutual Legal Assistance (USA) Act ("MLAT Act");
- the Criminal Justice (International Co-operation) Ordinance 1991 ("CJICO");
- the Drug Trafficking Offences Act 1992 ("DTOA"); and
- the Proceeds of Crime Act, 1999 ("PCA").

These statutes are dealt with below and in the section on money laundering.

14.2.3 **The CIO**

The CIO is similar to the Cayman Islands Confidential Relationships (Preservation) Law. It codifies the English common law duty of confidentiality owed by a bank to its customer, extends the duty to other professional relationships and criminalises a breach of that duty. Although Government officers, including the Director of the FSC and his staff, are not "professional persons" within the meaning of the CIO, the CIO applies to them in respect of any confidential information which comes into their possession.

Subject to certain exceptions, set out in section 3 of the CIO, a breach of the CIO renders the offender liable to a fine of up to

EC$50,000 and a term of imprisonment of up to two years. Where the offender receives a reward, a further fine of up to EC$50,000 and a further term of imprisonment of up to 2 years may be imposed on him. Furthermore, his reward may be forfeited.

14.3 Co-operation between regulatory authorities

14.3.1 Legislative gateways

14.3.1.1 *The OBO and the CMA*

The OBO (in Section 10) and the CMA (in Section 15) contain provisions which enable the Financial Secretary (under the OBO) and the Inspector of Company Managers (under the CMA) to require the production of and/or access to the books and records of a licensee and to demand information and explanations from a licensee.

The OBO and the CMA both restrict the access of the Financial Secretary (OBO) and the Inspector (CMA) to client files and information without a Court Order or, in the case of the CMA, the consent of the client.

The OBO and the CMA both impose restrictions upon the disclosure of information which the Financial Secretary or the Inspector have obtained in the discharge of their duties.

The restrictions on disclosure do not apply:

- in the case of the OBO when disclosure of information about the licensee is made by the Financial Secretary to a banking supervisory authority or any other regulatory authority; and
- in the case of the CMA, when disclosure of the information is made by the Governor or the Inspector of Company Managers when lawfully required to do so by the Court or under any other law (for example under the EIA).

A disclosure to a foreign regulatory authority by the Financial Secretary under the OBO is not required to be subject to a condition that the foreign regulatory authority is subject to adequate legal restrictions on further disclosure.

There is no restriction on the type of information which may be disclosed through the gateways described. In the circumstances, if the Financial Secretary or Inspector has client information, he may disclose it.

14.3.1.2 *EIA*

Section 3 of the EIA permits the Attorney-General, the Director of the FSC, the Registrar of Companies and the Registrar of Offshore Companies to disclose information received in the course of their functions under any Act for the purposes of enabling or assisting the foreign regulatory authority to exercise regulatory functions.

The EIA does not apply to the Inspector of Company Managers or the Financial Secretary (who is the day-to-day supervisor under the OBO).

14.3.1.3 *IO*

There is no provision for information sharing under the IO.

14.3.1.4 *Domestic banks*

The OBTCA does not apply to domestic banks, which are regulated by the ECCB.

Currently there is no ongoing dialogue between the ECCB and local regulators even in situations where the regulatory bodies may have overlapping responsibilities. However, the ECCB does exercise consolidated supervision and looks at all areas of operation within the banks under its supervision.

The ECCB has stated that it lacks the powers to co-operate with regulators in other jurisdictions in respect of Montserrat domestic banks. The ECCB is currently developing amending legislation to rectify this deficiency.

However, the ECCB has also advised us that it has had no difficulty in obtaining information from Montserrat domestic banks.

14.3.1.5 *CIO*

As stated, the CIO applies to the regulators in Montserrat in respect of any confidential information which comes into their possession. However, section 3(2)(e) of the CIO provides that the CIO does not apply to the seeking, divulging or obtaining of confidential information in accordance with the provisions of any other Ordinance.

In the circumstances, the operation of the CIO is excluded where information is disclosed under the OBO, the CMO or the EIA.

14.3.1.6 ***Securities/investments, mutual funds, stock exchanges***

Section 47 of the draft Bill for a Securities Act proposed by the ECCB requires the Securities Commission to maintain a detailed register of persons holding licences under the Act.

However the draft Bill only permits the Securities Commission and the Securities Exchange to exchange information with each other and with other securities markets and clearing houses. There is no provision for the disclosure of information to foreign securities regulators.

There is no proposed power for the Securities Commission to obtain information on behalf of other regulators. We do not know whether it is intended that the EIA will apply to the Securities Commission.

14.3.1.7 ***Companies, trusts and limited partnerships***

There is no provision under the IBC Ordinance or the CO concerning the sharing of information with other persons.

However, the Registrar of Companies and the Registrar of Offshore Companies are both regulatory authorities for the purposes of Section 3 of the EIA.

Disclosure of information in respect of companies, trusts and partnerships is discussed further in earlier sections of this Report on each of these areas.

14.3.2 **Compulsory powers**

The EIA is designed to implement the Model Compulsory Powers Ordinance ("the Model Ordinance") which is annexed to the Guidance Notes. We have reviewed the EIA against the Model Ordinance and noted the following differences:

- the gateway in section 3 does not extend to any matters relating directly or indirectly to the imposition, calculation or collection of taxes;
- there is no power for the Director of the FSC to examine a person under oath unless a magistrate approves;
- there is no provision in the EIA allowing the Director of the FSC to decline to exercise his powers if the information may be used against the person giving it; and
- the EIA includes a requirement that an agreement with the State of the requesting regulator be in effect, or that the Attorney-General gives his approval, prior to the requested information being provided.

We note that the EIA does not apply to the Inspector of Company Managers or the Financial Secretary.

14.3.3 **Memoranda of understanding**

There are no memoranda of understanding in place between Montserrat and any foreign regulatory authorities, however Montserrat are currently identifying jurisdictions with whom MOUs would be appropriate.

14.3.4 **Confidentiality of information received from foreign regulatory authorities**

Section 7 of the EIA imposes restrictions upon the Director of the FSC, the Registrar of Companies, the Registrar of Offshore Companies and imposes restrictions upon the disclosure of information received from a foreign regulatory authority.

14.4 **Co-operation between law enforcement authorities**

14.4.1 **Legislation**

14.4.1.1 ***MLAT Act***

The MLAT Act gives effect in Montserrat to the Mutual Legal Assistance Treaty agreed between the UK and the USA in 1986 ("the Treaty"). The objective of the MLAT Act is to enable the provision of mutual legal assistance between the USA and Montserrat for the prosecution, investigation and suppression of criminal offences. Virtually identical legislation is in place in the other Caribbean Overseas Territories.

For the purposes of the Treaty, a criminal offence is either conduct which satisfies the dual criminality test, ie it is conduct which is punishable by imprisonment of more than one year in both Montserrat and the USA, or it is one of a number of specific listed offences which include insider trading and fraudulent securities practices.

Article 1 of the Treaty defines the scope of assistance to be provided. The Article states that mutual assistance is to be provided for the investigation, prosecution and suppression of criminal offences covered by the Treaty. With the exception of certain civil and administrative proceedings relating to narcotics, the Treaty does not extend to civil matters.

The Treaty can be used both for the obtaining of information and evidence and for search and seizure. However information or evidence obtained cannot be used for purposes other than those stated in the request without the approval of the party to whom the request is made.

A person who divulges confidential information in conformity with a request is given immunity from any action for breach of confidentiality.

The Authority under the MLAT Act in Montserrat is the Attorney-General. The US Authority is the Department of Justice.

14.4.2 **CJICO**

The CJICO is similar to the UK's Criminal Justice (International Co-operation) Act 1990 (the "UK Act"). It gives substantial effect to the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

The provisions of the CJICO concerning co-operation include:

- the mutual service of process, in criminal matters;
- the mutual provision of evidence in criminal matters;
- the issue of search warrants in Montserrat;
- the enforcement in Montserrat of overseas forfeiture orders in respect of drugs or drug trafficking offences; and
- extradition for drugs or drug trafficking offences.

The CJICO was amended by the Criminal Justice (International Co-operation) (Amendment) Act 1999 which introduced additional powers relating to ships in the territorial waters of Montserrat.

14.4.2.1 ***PCA***

Sections 41 to 46 of the PCCA provide for the registration and enforcement of external confiscation orders.

14.4.3 **Provision of co-operation**

In the case of a request for assistance emanating from the USA, a request may be made by the Department of Justice to the Attorney-General under the MLAT Treaty or by the appropriate US authority under CJICO.

A request for assistance under CJICO may be made by the appropriate authority of any jurisdiction by letter of request sent by that authority to the Attorney-General.

No information is available on the number of requests for assistance under the MLAT Treaty.

14.5 **Requests to other jurisdictions for assistance in criminal and regulatory matters**

Montserrat has made no requests to other jurisdictions for assistance and it is therefore impossible to comment on the level of co-operation received.

14.6 **Co-operation between regulatory and law enforcement authorities**

There is no provision in the financial regulatory legislation formally enabling the regulator to disclose matters to the police.

However, section 7(2) of the EIA provides a gateway which enables the Director of the FSC to pass information obtained under the EIA to any person with a view to the institution of, or otherwise for the purpose of criminal proceedings.

However, the CIO does not apply to confidential information given to or received by a police officer of the rank of Inspector or above investigating an offence committed or alleged to have been committed within the colony.

14.7 Co-operation on fiscal matters

14.7.1 MLAT Act and Treaty

Conduct which relates directly or indirectly to the regulation, imposition, calculation or collection of taxes is excluded from the Treaty with the exception of tax fraud and the wilful or dishonest making of false statements to government tax authorities (eg by submitting a false tax return). Therefore, unless the request relates to these exceptions co-operation cannot be provided.

14.7.2 CJICO

The CJICO extends to fiscal offences, except that the Governor shall not exercise his discretion where it appears that the request relates to a fiscal offence in respect of which proceedings have not yet been commenced unless:

- the request is from a Commonwealth country, or is made pursuant to a treaty to which the United Kingdom is a party and such a treaty has been made applicable to Montserrat; or
- he is satisfied that the conduct constituting the offence would constitute an offence if committed in Montserrat.

This provision matches that contained in Section 4(3) of the UK Act.

14.7.3 EIA

As stated above, the gateway in the EIA does not extend to any matters relating directly or indirectly to the imposition, calculation or collection of taxes.

14.8 Intelligence networks

Montserrat participates in the Overseas Territories Regional Criminal Intelligence System ("OTRCIS"). This system, which is operated out of Miami, is aimed at assisting the Caribbean Overseas Territories law enforcement personnel to combat local criminality occurring in each individual Territory, as well as the threat posed by drug trafficking and organised crime, including money laundering. OTRCIS provides a secure database on information relating to criminal and suspected criminal activity in the Overseas Territories.

14.9 Support

14.9.1 Resources

There are no Montserrat Government employees dedicated to the issue of international co-operation.

Legal support on matters of co-operation, both criminal and regulatory, is provided by the Attorney-General's Chambers.

14.9.2 Egmont Group of Financial Intelligence Units

Montserrat is not a member of the Egmont Group.

14.9.3 White Collar Criminal Investigation Team

Additional support is available to the police in Montserrat and the regulators through the White Collar Criminal Investigation Team ("WCCIT"). This is a joint UK/FBI team operating out of the FBI offices in Miami. Currently two UK police officers are seconded to the team. These officers are also sworn in as police officers in each of the Caribbean Overseas Territories.

The role of WCCIT is to undertake and assist in the investigation of white collar crimes involving the US, the UK and the OTs in the Caribbean.

WCCIT does not have authority to initiate investigations in respect of drugs and drug related offences. There are resources available to assist the OTs with anti-drug trafficking investigations through the drugs liaison network in the regions. There is also a UK appointed Drugs Law Enforcement Adviser for the OTs available to assist with OT related drugs matters.

14.10 Issues and recommendations

14.10.1 Introduction

Montserrat has taken a number of positive steps to improve its ability to co-operate with foreign law enforcement and regulatory authorities. In particular, it has implemented most elements of the Model Compulsory Powers Ordinance through the EIA.

There are, however, a number of areas where further development is still required and these are detailed below. In particular, it is essential that the relevant regulator has access to client information.

14.10.2 Co-operation between regulatory authorities

14.10.2.1 *Scope of existing gateways*

The Guidance Notes require that the statutory gateways should extend to client information. The gateway in the OBO does extend to client information, but only if the information is in the regulator's possession. The current inability of the regulator to access client information without a Court Order restricts his ability to co-operate with foreign regulatory authorities.

Authority to pass information under the gateway in the OBO is given to the Financial Secretary. We consider that this is inappropriate. Authority should be vested within the FSC.

Additional provision needs to be inserted into the OBO to ensure that information may only be passed to a foreign regulatory authority where the regulator is satisfied that the foreign regulatory authority is subject to adequate legal restrictions on further disclosure and that the disclosure is required for their regulatory function.

There are no statutory gateways in the CMA or the IA. Given that the gateway provisions in section 3 of the EIA do not extend to the Inspector of Company Management or the Registrar of Insurers, (or to the Financial Secretary) there are no clear gateways in respect of licensees under the CMA or licensees under the IA. However, in practice, this may not be a problem as the Director of the FSC can, on the request of a foreign regulatory authority, acquire the information using the compulsory powers contained in sections 4 and 5 of the EIA and disclose it to the foreign regulatory authority.

We consider that the exclusion from the gateway of assistance in respect of matters relating "directly or indirectly" to the imposition of taxes is too wide. A considerable body of regulatory enquiries could be considered as "indirectly" relating to tax. If there is a desire to protect the confidentiality of information submitted to a foreign regulator this should be dealt with in another manner.

14.10.2.2 *Securities/investments, mutual funds and stock exchange*

We consider the gateways proposed in the draft Securities Act fail to meet international standards concerning international co-operation as they do not provide for any gateways for the Securities Commission to exchange information with regulators undertaking a similar function in other jurisdictions.

Furthermore the condition contained in section 88 that the Securities Commission may only inspect under "conditions of secrecy" appears to further inhibit its ability to comply with international standards on co-operation.

We do, however, consider the proposal for a public register of details relating to licence holders to be a highly positive action in respect of transparency. We recommend that consideration is given to amending the draft Bill to include the licence holders' published accounts in the information available on the register.

14.10.2.3 *Compulsory powers*

The Model Compulsory Powers Ordinance was developed by the UK and discussed with the OTs at a number of Attorney-Generals' Conferences. It is designed to provide OT regulators with powers to compel the production of information from both regulated and unregulated individuals and entities in order to satisfy a request for assistance made by a foreign regulator. As regulatory requests are civil rather than criminal, they cannot generally be made under legislation which enables the provision of assistance in criminal matters. Such powers are envisaged by IOSCO and represent good practice.

The Guidance Notes require that legislation equivalent to the Model Ordinance is enacted in each OT. We consider this to be a codification of good practice.

As discussed, the EIA provides broad equivalence with the Model Ordinance.

However there are two important differences between the EIA and the Model Ordinance as regards compulsory powers. These are:

- there is no power for the Director of the FSC to examine a person under oath unless a magistrate approves;
- there is no provision in the EIA allowing the Director to decline to exercise his powers if the information may be used against the person giving it.

We recommend that the EIA is amended to remove the above differences.

14.10.2.4 ***MOUs***

As indicated, there are no MOUs in place between regulators in Montserrat and foreign regulatory authorities.

The TORs require that MOUs are put in place where necessary. The legislation does not require MOUs to be put in place and there is no evidence that the lack of MOUs is preventing or hindering the regulators in Montserrat from co-operating with foreign regulatory authorities.

However, section 4(2) of the EIA envisages the agreement of MOUs for the purposes of providing assistance utilising the compulsory powers contained in sections 4 and 5. We note that the section refers to agreements to which "Montserrat and the State of the foreign requesting authority are parties". As MOUs are generally entered into directly by regulators, not governments, the reference to "state" needs to be removed from section 4(2).

Although the existence of MOUs is not essential for the provision of assistance under the EIA, we consider that MOUs are a useful tool and that where they are in place they facilitate the prompt exchange of information between regulators.

We recommend, therefore, that MOUs are entered into, especially with those regulatory authorities with whom the Montserrat regulators have more frequent contact.

We also consider that the absence of a MOU between the FSD and ECCB is a weakness. If the domestic and offshore banking sectors are to continue to be regulated by two different supervisors, a MOU and agreement on lead supervision must be concluded.

14.10.2.5 ***Confidentiality of information received***

The Guidance Notes require that regulators are able to safeguard the confidentiality of information provided to them by foreign regulatory or law enforcement authorities.

This is covered in respect of information supplied to the Director of the FSC pursuant to Section 7 of the EIA.

It is also arguable that information supplied to the regulators in Montserrat by a foreign regulator is covered by the CIO and by the confidentiality provisions in the OBO and the CMO, but we consider that this is not certain.

In the circumstances, we consider that it would be advisable for comprehensive provision to be made in the EIA.

14.10.3 **Co-operation between law enforcement authorities**

14.10.3.1 ***CJICO***

The CJICO is very similar to the UK Act and provides for a significant level of international co-operation. In particular, there is no requirement for dual criminality on an application from a foreign law enforcement authority to obtain evidence in Montserrat in connection with foreign criminal proceedings.

We consider that the CJICO fully meet international standards.

14.10.3.2 ***MLAT Act***

Our discussions with the US Department of Justice indicate that the Department is relatively comfortable with the operation

of the Treaty in practice, although they considered the level of resources available to provide a swift response are limited.

A lack of available data has not allowed us to determine whether this concern is justified.

14.10.3.3 ***Restrictions on the ability to co-operate in relation to financial offences***

Given the requirement for dual criminality in relation to the exchange of information under the MLAT Act, it may not be possible to provide co-operation in respect of conduct which may constitute a financial services criminal offence in the USA but which does not constitute a criminal offence in Montserrat. However, a number of matters which are not offences in Montserrat are specified in the Treaty.

As indicated above, the provision of evidence under CJICO does not require dual criminality.

If the Department of Justice is unable to use the MLAT Act to obtain evidence in Montserrat in respect of a US financial crime which is not an offence in Montserrat, it is open for an application to be made under CJICO.

14.10.3.4 ***Tracing, freezing and confiscating of proceeds of crime***

The CJICO provides for the enforcement of overseas forfeiture orders in drug cases.

The PCA provides for the enforcement of overseas forfeiture orders in non-drug cases.

However, the PCA depends upon dual criminality and therefore does not extend to conduct which may be a financial crime in a foreign jurisdiction but which is not an indictable offence in Montserrat (for example, insider trading and market manipulation). Therefore, the provisions which permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

Compliance could be achieved by extending the range of financial crimes.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or flee clauses. Please see our recommendations concerning flee clauses in the section on Trusts.

14.10.4 **Co-operation between regulatory and law enforcement authorities**

As indicated, there is no specific provision in any financial regulatory legislation formally enabling the regulator to disclose matters to the police.

Although the CIO does not apply to confidential information given to, or received by, a police officer of the rank of Inspector or above in the circumstance outlined earlier in this Report, we note that this is not an enabling power. It simply provides that the CIO does not apply. In the circumstances, if information is confidential other than through the application of the CIO, this exception would not assist.

Specifically, the exception to the CIO does not assist in respect of information which the relevant Inspector is required to keep confidential by virtue of the OBO or the CMO.

As indicated, Section 7(2) of the EIA provides a gateway which enables the Director of the FSC to pass information obtained under the EIA to any person with a view to the institution of, or otherwise for the purpose of, criminal proceedings. This does not extend to information needed at the investigatory stage.

In the circumstances, we recommend that specific statutory provision is made enabling the regulators in Montserrat to disclose information to the Montserrat police.

In addition, whilst the relationship between the regulators and the police is good, in order to demonstrate compliance with good practice guidelines, there needs to be a formal communication process whereby the police advise the FSD of the findings of investigations relating to fraud and money laundering and we recommend that appropriate procedures are put in place.

14.10.5 **Transparency in co-operation**

Discussions within and outside Montserrat indicate that the potential gateways for co-operation are not always well understood by those requesting assistance. Failure to utilise the appropriate gateway can lead to delay and the impression of a lack of co-operation.

To address this issue, the Montserrat Government should produce and publish (possibly via the World Wide Web) guidance notes on the international co-operative gateways for both civil and criminal requests for assistance.

We therefore recommend that the Montserrat Government should produce guidance notes for regulators and criminal authorities in other jurisdictions detailing the types of co-operation available and the appropriate procedures for seeking co-operation.

14.10.6 **Resources**

Montserrat makes and receives very few requests for assistance. Whilst there are no individuals dedicated to the issue of international co-operation, there is no indication that there are insufficient resources available to provide information when requested. However, we do recommend that appropriate information monitoring procedures are put in place.

Concern was however expressed by the police of the need for support from outside the jurisdiction in assisting with financial offences, particularly complex cases. In light of these concerns, we consider that there is a need to ensure that Montserrat is provided with adequate experienced police resources for the investigation of complex financial crime.

14.10.7 **WCCIT**

To facilitate the full assistance of WCCIT in relation to money laundering offences we recommend that the current exclusion of drug related matters from its scope is removed.

We welcome your comments on this site.

Prepared 27 October 2000

15 Anti-money laundering

15.1 Introduction

A number of international standards are in place setting legislative and practical measures that should be taken to combat money laundering. These are contained principally in the FATF 40 Recommendations and the CFATF 19 Recommendations, the Vienna Convention and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. We are asked to consider to what extent the OTs apply the standards set out in these documents together with those documents contained in the EC Money Laundering Directive (June 1991).

Our review falls into two parts. The first is a review of the legislation, regulations and guidelines in place. The second is a review of the implementation of the legislation, regulations and guidelines, especially as regards the reporting, handling and investigation of suspicious transaction reports.

15.2 Factual assessment

15.2.1 Legislation

15.2.1.1 *Introduction*

Montserrat has three main pieces of legislation dealing with money laundering:

- the Drug Trafficking Offences Ordinance, 1990 ("DTOO");
- the Criminal Justice (International Co-operation) Ordinance, 1991 ("CJICO"); and
- the Proceeds of Crime Act, 1999 ("PCA").

15.2.1.2 *DTOO*

Offences

The DTOO was enacted to implement the drug trafficking aspects of the Vienna Convention in Montserrat. The following money laundering offences were created by the DTOO:

- assisting another to retain the benefit of drug trafficking (Section 21); and
- prejudicing an investigation (Section 27).

The *mens rea* for the offence of assisting is "knowing or having actual suspicion" that the person assisted is carrying on or has carried on drug trafficking.

The offence provisions of the DTOO apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit offences under the Act.

Other provisions

Section 3 of the DTOO enables the Court to confiscate the proceeds of drug trafficking and sections 10 to 12 give the Court the power to make restraint orders and charging orders.

Sections 22 and 23 of the DTOO establish procedures for registering at Court and enforcing foreign confiscation orders made by the court of a designated country. The list of countries designated is comprehensive.

The DTOO also provides for production orders (section 24) and search warrants (section 25).

Section 21 of the DTOO provides for the reporting of suspicious transactions to a police officer. The section provides that if a person makes a disclosure to a police officer:

- disclosure shall not be treated as a breach of any duty of confidentiality imposed by contract; and
- provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

As its name suggests, the DTOO is concerned with drug trafficking and its money laundering provisions are therefore limited to those dealing in the proceeds of the underlying (or "predicate") offence of drug trafficking.

15.2.1.3 ***CJICO***

General provisions

The CJICO enables Montserrat to co-operate with other countries in criminal proceedings and investigations through mutual legal assistance. This is discussed further in the section on International Co-operation.

The CJICO also provides for the enforcement of overseas forfeiture orders in drug cases.

Drug trafficking offences

Section 13 of CJICO creates the offence of concealing or transferring the proceeds of drug trafficking and the offence of acquiring another person's proceeds of drug trafficking. The latter offence does not extend to possessing or using another's proceeds of drug trafficking.

The *mens rea* for concealing or transferring or acquiring the proceeds of another's drug trafficking is "actual knowledge or reasonable belief" that the property represents the proceeds of another's drug trafficking.

The offence provisions of the CJICO apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit an offence under the Act.

PCA

Montserrat has introduced "all crimes" anti-money laundering legislation through the PCA. The money laundering provisions in the PCA apply to "criminal conduct" which is defined as an indictable offence or conduct taking place outside the jurisdiction which would constitute such an offence if it had occurred in Montserrat. This concept is known as "dual criminality". Drug trafficking offences are specifically excluded.

The following money laundering offences were created by the PCA:

- assisting another to retain the benefit of criminal conduct (section 31);
- acquisition, possession or use of proceeds of criminal conduct (section 32);
- concealing or transferring proceeds of criminal conduct (section 33); and
- tipping off (section 34).

The *mens rea* for the above offences is as follows:

- the offence of assisting: "actual knowledge or suspicion" that the person assisted is or has been engaged in criminal conduct;
- the offence of acquisition, possession or use: "actual knowledge" that the property is the proceeds of criminal conduct; and
- the offence of concealing or transferring: "knowing or having reasonable grounds for suspecting" that the property is the proceeds of criminal conduct.

Sections 31 and 32 of the PCA provide for reporting suspicious transactions to a Reporting Authority appointed under section 30. Both sections provide that if a person makes a suspicious transaction disclosure to the Reporting Authority:

- disclosure shall not be treated as a breach of any duty of confidentiality imposed by enactment or rule of law and shall not give rise to any civil proceedings; and

- provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

Sections 10 to 14 of the PCA provide for confiscation orders and sections 19 to 21 provide for restraint and charging orders. Section 38 enables the High Court to make an Order for the production of material relevant to an investigation into money laundering on the application of a police officer and section 39 enables a police officer to apply to the Court for a search warrant.

Sections 41 to 46 of the PCA provide for the registering and enforcing external confiscation orders. We understand that an Order designating countries to which the sections apply was issued subsequent to our visit, but we have not seen it and do not know how comprehensive it is.

15.2.2 **Regulations**

The only regulation that has been made relating to money laundering is the Drug Trafficking Offences Ordinance 1990 (Designated Countries and Territories) Order 1996 ("Drug Trafficking Order").

No anti-money laundering regulations have been made under the PCA, although we are advised that regulations have been drafted and that they are equivalent to the UK money Laundering Regulations, 1993. We have been advised that subsequent to our visits, the regulations have been passed by the Executive Council and will come into force on publication.

15.2.3 **Guidance notes**

Although the PCA provides for the Governor to issue an Anti-Money Laundering Code of Practice, a Code of Practice has not yet been issued.

The ECCB has issued administrative guidelines to domestic banks. These are enforced by review during the on-site visits. The ECCB regard the guidelines as minimum standards and expect that the guidelines will be bolstered either by all crimes money laundering legislation, or regulations or guidance notes made thereunder, in the jurisdiction in which the bank is situate, or by the bank's own requirements.

We note that Guidance Note 10 of the ECCB Guidance Notes begins:

"Where a financial institution chooses to make no report to the law enforcement authorities on the suspicious activity of one of its customers_".

15.2.4 **Fiscal offences**

Fiscal offences are not predicate offences under the PCA and therefore co-operation cannot be provided. However, if an offence caught by the PCA, such as fraud, has a fiscal element co-operation can still be given.

15.2.5 **Anti-money laundering - framework, system and procedures**

15.2.5.1 ***Framework***

Currently there are no anti-money laundering regulatory or law enforcement systems, procedures or framework in place in Montserrat. We further understand that no suspicious transaction reports have ever been made.

15.2.5.2 ***Domestic banks***

During the course of on-site visits the ECCB checks compliance with its transaction reporting requirements and its Administrative Guidelines (which cover, for example, customer identification guidelines and the adequacy and frequency of training).

15.2.5.3 ***Financial Investigation Unit/suspicious transaction reporting***

No formal reporting authority has been established and there is no FIU. All reports of suspicious transactions must be made to the police. There is, however, provision under the PCA for the creation of a Reporting Authority.

No reporting authority is in place as the Governor in Council has not made an Order constituting it as required by section 30 of the PCA.

The position regarding reporting suspicious transactions in Montserrat is unclear. The PCA makes provision for a Reporting Authority but requires that any reports of suspicious transactions are made to the police.

15.2.5.4 ***Attorney-General's Chambers***

The Attorney-General's Chambers are the legal advisers to all official parties enforcing money laundering legislation. The Chambers currently comprise three staff, the Attorney General, a Crown counsel and a parliamentary draftsman.

15.2.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies, is primarily undertaken through participation in the CFATF.

15.2.7 **Other measures to avoid money laundering**

There are no direct measures to detect or monitor cross-border transportation of cash and bearer instruments. However the Financial Secretary is required to give his approval for transfers of any amounts above EC$250,000 within the Eastern Caribbean region.

There are no requirements to report transactions above a certain value.

There is no measurement system in place recording the international flow of cash and bank transfers into or out of Montserrat.

Montserrat legislation does not distinguish between launderers who are public officials and others. Montserrat has power under the MLAT to share assets seized with the US. There is no other jurisdiction with whom Montserrat has this arrangement.

15.3 **Issues and recommendations**

15.3.1 **Introduction**

Montserrat's primary legislation is modern and reasonably extensive. It contains most of the material and covers most of the issues that we would expect in a jurisdiction that is fully compliant with international standards. In particular, we are satisfied that the legislation taken as a whole enables Montserrat to comply with most of the relevant parts of the Vienna Convention and the associated FATF and CFATF Recommendations. The exceptions relate to the lack of offences of tipping off (in drug trafficking matters) and possessing another's proceeds of drug trafficking.

There remain some other deficiencies in the legislation that should be addressed as swiftly as possible. These are discussed below.

There are currently no regulations or guidance notes in place to support the primary legislation. At the time of our review, therefore, Montserrat was not in compliance with international standards, especially those FATF and CFATF Recommendations that apply to customer identification, record keeping and other anti-money laundering systems and procedures, the reporting of suspicious transactions to a reporting authority and the international standards reflected in the EC Money Laundering Directive of 1991. The lack of regulations and guidance notes is of particular concern given the number of licensed banks with no actual presence in Montserrat but which nevertheless need to be subject to appropriate anti-money laundering requirements.

We were advised that regulations equivalent to the UK Money Laundering Regulations, 1993 and a Code of Practice have been drafted. Although this is encouraging, we have not seen the drafts and cannot, therefore, assess whether they comply with international standards.

A reporting authority has not been established and there is no effective infrastructure for the investigation and prosecution of money laundering offences. As we have discussed elsewhere in this Report, this is understandable given the problems that Montserrat has faced following the volcanic eruptions but will need to be addressed urgently if the jurisdiction is to comply with international standards.

15.3.2 **Legislation**

15.3.2.1 ***DTOO & CJICO***

As indicated above, the offences of acquiring and concealing the proceeds of drug trafficking were created by the CJICO. However, the offences of tipping off and possessing and using another's proceeds of drug trafficking are not provided for in either the CJICO or the DTOO. Montserrat therefore does not fully comply with FATF Recommendation 17 and does not give full effect to article 3 of the Vienna Convention. We recommend that the DTOO should be amended to include the above offences.

The *mens rea* for the offences of assisting and acquiring is restricted to "knowledge or actual suspicion". We consider that the *mens rea* for the offences should be extended to cover a person who "has reasonable grounds for suspecting" that the proceeds were derived from drug trafficking. Provided that the same change is made to the PCA, this will bring Montserrat into line with what was envisaged by CFATF Recommendation 4.

The *mens rea* for the offence of concealing is "knowing or having reasonable grounds to suspect". This is in compliance with CFATF Recommendation 4.

We recommend that:

- the DTOO should be amended to include the offences of tipping off and of possessing and using another's proceeds of drug trafficking; and
- the *mens rea* for the offence of assisting and the offence of acquiring in the DTOO should be extended to cover reasonable grounds for suspecting. (We are advised that subsequent to our visits, this change has been made.)

15.3.2.2 ***PCA***

Sections 41 to 46 of the PCA provide for registering and enforcing external confiscation orders. We understand that an Order designating countries to which the sections apply has been issued subsequent to our visits. As we have not seen it and do not know how comprehensive it is, we are unable to assess whether Montserrat is in full compliance with FATF Recommendation 38.

The *mens rea* for the offences of assisting and acquiring is restricted to "knowledge or actual suspicion" that the property represents the proceeds of crime. We consider that the *mens rea* should be extended to cover "reasonable grounds for suspecting" that the property represents the proceeds of crime as envisaged by CFATF Recommendation 4.

The mens rea for the offence of acquisition is restricted to "knowing" that the property is the proceeds of crime. This is far too restrictive. It should be extended to cover "actual suspicion and reasonable grounds for suspecting" that the property represents the proceeds of crime.

There is no gateway in the PCA permitting onward disclosure of reports to other criminal authorities. This is needed to comply with FATF Recommendation 32.

We note that Montserrat does not distinguish between launderers who are public officials and others, as envisaged by CFATF Recommendation 5. Sentencing discretion should enable the judiciary to set higher penalties for public officials who commit money laundering offences. However, as there have been no money laundering prosecutions, it is unclear whether sentencing policy would reflect CFATF Recommendation 5.

There is no requirement to report transactions above a certain value. Whilst such a system is envisaged by FATF Recommendation 23 and CFATF Recommendation 14, the Recommendations do not make such a provision mandatory. We consider that a decision upon whether such a reporting regime should be implemented is for the jurisdiction itself to take rather than an international standard.

We recommend that:

- the PCA should be amended to include the offences of tipping off and of possessing and using another's proceeds of drug trafficking; and
- the *mens rea* for the offence of assisting and the offence of acquiring in the DTOO should be extended to cover "reasonable grounds to suspect". (We are advised that subsequent to our visits, this change has been made.)

15.3.3 **Money Laundering Regulations**

We consider that Montserrat should bring money laundering regulations into effect as soon as possible.

The current absence of regulations means that Montserrat is not in compliance with FATF Recommendations 8, 9, 10, 11, 12, 18, 19, 20 and 21 and CFATF Recommendation 13.

The know your customer requirements in these regulations should cover existing as well as future customers.

In respect of FATF Recommendation 19 we consider that testing compliance should form part of the on-site inspection process of the regulator.

The regulations should provide that persons undertaking due diligence audits, including the regulator, have the power to review client files in so far as is necessary to confirm compliance with the regulations. This is covered more fully in other sections of this report.

We also consider that there should be a formal requirement for an audit of firms' anti- money laundering systems and that the audit of a regulated entity should include assessing compliance with the regulations.

We therefore recommend that:

- anti-money laundering regulations in compliance with the FATF requirements should be introduced as a matter of urgency;
- testing compliance with the regulations should form part of the audit process and the regulator's on-site inspection; and
- for the purposes of due diligence audits and on-site inspections, full access should be given to client files.

15.3.4 **Guidance Notes**

15.3.4.1 ***Introduction***

As indicated, although the PCA provides for a Code of Conduct to be issued by the Governor, no such Code of Conduct has yet been issued.

15.3.4.2 ***ECCB Administrative Guidelines***

The ECCB Administrative Guidelines apply only to domestic banks.

Whilst we appreciate that the ECCB Administrative Guidelines are designed to establish only minimum standards, we do not consider them to be adequate. In the absence of a general Code of Practice, the ECCB should be encouraged to produce more definitive guidance to its licence holders concerning anti-money laundering systems and procedures. In particular, the Guidelines are too general and do not provide sufficient guidance to banks on areas such as introduced business.

We also recommend that Guidance Note 10, which appears to accept that there are circumstances when banks might not report a suspicious transaction, should be removed. We do not consider there to be any circumstance where non-reporting of a suspicious transaction is an option.

15.3.4.3 ***General Code of Practice***

At the time of our visits, no General Code of Practice had been issued. We consider that the introduction of enforceable Guidance Notes is a significant component of a jurisdiction's commitment to deter money laundering. Therefore, the lack of a Code of Practice is a breach of FATF Recommendation 28.

We recommend that a Code of Practice should be introduced at the same time as the regulations. At the time of our visits, we were advised that a Code of Practice had been drafted and have subsequently been advised that the Code of Practice has been passed. This is encouraging, but we have not seen the draft and have, therefore, been unable to assess it for the purposes of this Report.

15.3.5 **Framework, systems, procedures and resources**

15.3.5.1 ***Reporting Authority/FIU***

The current lack of an FIU is of concern, although we do understand the practical difficulties for an island with a population of only 4,500. Consideration needs to be given on the process for handling suspicious transaction reports and investigations.

Given the limited resources available, the work of the FIU and the limited number of reports that can reasonably be expected, the role may form part of the functions of another department of the police or a separate Reporting Authority.

Additionally, the role of the Reporting Authority needs to be clarified and an Order bringing it into effect, made.

There also needs to be a system for ensuring that international trends in money laundering can be monitored and acted upon. This will facilitate compliance with FATF Recommendation 13.

We recommend that:

- the Order detailing the operation and structure of the Reporting Authority should be made, so bringing the Reporting Authority into existence;
- the role of the Reporting Authority is clarified and, where necessary the PCA should be amended to reflect its role by making it the recipient of suspicious transaction reports rather than the police; and
- the DTOO should be amended making the Reporting Authority the recipient of suspicious transaction reports rather than the police.

15.3.5.2

Attorney-General's Chambers

The limited resources of the Chambers and its workload, particularly on the introduction of new legislation, means that its resources would be unlikely to cope with a significant level of anti-money laundering and international co-operation work. The Attorney-General recognises the need for additional resources if these activities increase.

15.3.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies, is primarily undertaken through participation in the CFATF. The current limited resources and lack of a formalised process for monitoring means that Montserrat may not always be up to date with developments.

15.3.7 **Monitoring of compliance by regulated institutions**

The scope of regulatory review of financial institutions needs to be expanded to include an assessment of their compliance with the new requirements when they are in place. This will enable Montserrat to comply with FATF Recommendation 27.

15.3.8 **Business awareness**

We consider that the fact that there have been no suspicious transaction reports made, at least in the last few years, may be indicative of a lack of understanding of the legislation by the private sector. The introduction of regulations must therefore be accompanied by a formal training workshop(s) for the private sector advising them of their responsibilities under the legislation and regulations. It is vital that this understanding is also communicated to those offshore banks with no presence in Montserrat.

15.3.9 **Other regulations**

The lack of a regulatory system for securities and investment business and the lack of ongoing checks on the directors and officers of licensed banks may mean that persons who are not "fit and proper" can operate a financial institution. This is not in accordance with FATF Recommendation 29. Our recommendations in relation to this are contained in other Sections of this Report.

15.3.10 **Cross-border flows**

There are no direct measures to detect or monitor cross-border transportation of cash and bearer instruments. However the Financial Secretary is required to give his approval on any amounts over EC$250,000 moving within the Eastern Caribbean region. Whilst such a detection system is envisaged by FATF Recommendation 22, the Recommendation does not make such a provision mandatory. We consider that a decision to implement such a system is for the jurisdiction itself rather than an international standard.

Nevertheless, although the level is likely to be small, Montserrat should consider co-operating with the ECCB to impose a

requirement upon licensed banks and other relevant institutions to report the cash flows to and from abroad, in accordance with FATF Recommendation 30 and CFATF Recommendation 15. Such reporting should be to the ECCB or the FSD.

We welcome your comments on this site.

Prepared 27 October 2000

Appendix 1

PREAMBLE: REVIEW OF FINANCIAL REGULATION IN THE CARIBBEAN OVERSEAS TERRITORIES AND BERMUDA

The Overseas Territories' White Paper proposes establishing a renewed contract between the UK and the Overseas Territories (OTs). A modern and effective partnership should be built upon the foundations of responsibilities on both sides, coupled with the UK assisting the OTs where necessary, and the OTs exercising control over their own lives in a responsible way.

The UK is pledged to look after the OTs' interests internationally. This goes hand in hand with the OTs meeting accepted international standards, and playing a responsible role in the international community. In the area of offshore financial services, some of the OTs are significant players in their own right. The business conducted in offshore centres is often linked intrinsically with activities regulated in other countries, including the UK and our key international partners. The quality of regulation in the OTs has an indirect or direct effect on people, firms, and markets in other countries, as well as the international financial system.

The Terms of Reference provide for an indepth independent review by experts to assess progress made in the regulation of the offshore sector, and to make further recommendations on how to deal with outstanding issues. HMG circulated Guidance Notes to Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands which indicate accepted international standards and good practice in financial regulation. Following consultation with these OTS, the Guidance Notes and Terms of Reference for the review of financial regulation in the OTs have been revised.

2 September 1999

TERMS OF REFERENCE FOR THE REVIEW OF FINANCIAL REGULATION IN ANGUILLA, BERMUDA, BRITISH VIRGIN ISLANDS, CAYMAN ISLANDS, MONTSERRAT AND TURKS AND CAICOS ISLANDS

PURPOSE OF THE REVIEW

To assess Overseas Territories' (OTs) performance against international standards and good practice as set out broadly in the Guidance Notes[3].

To make recommendations for improvement where the OTs fall below these standards.

REGULATION OF FINANCIAL ACTIVITY

The review should list separately the type and composition of offshore financial services business in each OT ie. Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands. It should ascertain what legislation, regulations, rules, guidance, systems, and procedures (statutory or otherwise) govern the regulation and supervision of the:

- banking sector;

- insurance sector;

- securities sector, including mutual funds and stock exchanges.

This assessment should cover the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulation and laws.

The review should evaluate to what extent arrangements in the OTs meet standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to relevant standards provided by these bodies are broadly set out in the Guidance Note covering this section. The review should consider the adequacy of the system of supervision relative to the

objectives of an OT's financial services regulation. It should comment on the existence and adequacy of depositor and investment protection schemes. The review should determine whether further action is required by any territory in order to meet the standards broadly set out in the relevant Guidance Note, and prioritise recommendations.

REGULATION OF COMPANIES, PARTNERSHIPS, TRUSTS

The review should supply a breakdown of the type and composition of the company, partnership, and trust sectors in each OT, including company and trust service providers and formation agents, the involvement of professionals (accountants and lawyers), and the scale of activity. It should determine and assess the legislation, framework, systems, rules, regulations, guidance and procedures in place which provide for the regulation of activity in these sectors. The review should establish whether these arrangements conform to good practice and standards outlined in the relevant Guidance Note, which in turn refers to the principles set out in: the Basel Committee on Banking Supervision; International organisation of Securities Commissions (IOSCO); the Financial Action Task Force 40 Recommendations; Caribbean Financial Action Task Force Aruba Recommendations, the International Accounting Standards Committee, the G22 report on Transparency and Accountability (October 1998), IMF Guide to Progress in Strengthening the Global Financial Architecture (April 1999) and the OECD Principles of Corporate Governance.

The review should evaluate the appropriateness of the regulatory measures in place, including the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulations, and laws.

Furthermore, it should ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts. The review should detail the type of information available on the activities of company, partnership and trust. It should determine whether the mechanisms in place are sufficient. The review should also consider whether further action is required by any territory to meet the standards broadly set out in the Guidance Note, and prioritise recommendations.

INDEPENDENT REGULATORY AUTHORITIES

The review should evaluate to what extent regulatory authorities comply with accepted international standards advocated, principally, by Basel, IOSCO, OGBS and IAIS.

In particular, the review should evaluate whether regulatory authorities are accountable, independent and free from business and political influence, and properly staffed and budgeted for, with an independent source of income. It should determine whether the authority is detached from the marketing of financial services and where this is not so any impact this may have on the ability of the regulatory authority to regulate the sector objectively. The review should assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance, and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; cooperate with requests for assistance from foreign authorities and; enforce rules, regulations, laws by taking enforcement action, and the extent to which they can liaise with law enforcement authorities in the sharing of information. The review should consider which activities fall under the responsibility of the regulatory authority, and whether the regulatory net covers all financial activities. it should comment on the resources available to the authority, both for the purpose of recruitment, training and retention of staff and its infrastructure, such as the use of technology.

The review should consider what legal advice is available to the authority and its effectiveness in helping the OT government to regulate the sectors.

INTERNATIONAL COOPERATION

The review should evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of OT law enforcement and regulatory authorities to cooperate with requests for assistance from foreign authorities. The necessary requirements are broadly set out in the relevant Guidance Note. The review should ascertain what legal advice is available to OT regulatory and law enforcement authorities and its effectiveness in helping the OT government to co-operate in these areas. The review should determine whether further action is required by any territory in any of these areas, and the relative priority of such action.

<u>Cooperation between regulatory authorities</u>

The review should consider whether there are effective 'Gateways' provisions in place; OTs' powers to obtain information, including by compulsion; ability of foreign authorities to take voluntary testimony from OT residents; an OT's ability to

safeguard the confidentiality of information provided by foreign counterparts; provisions governing conditions under which information may be passed to overseas jurisdictions; whether effective Memoranda of Understanding exist, where required to underpin cooperation.

Cooperation between law enforcement authorities

The review should assess the extent of cooperation to which OT law enforcement authorities can obtain evidence on behalf of their foreign counterparts, and exercisingother available mutual legal assistance powers, stating the mechanisms and OT authorities involved; an OT's ability to assist foreign authorities in tracing, freezing and confiscating proceeds in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (November 1990), even if the underlying conduct takes place outside the OT; the effectiveness of Mutual Legal Assistance Treaties with the USA where applicable, and the provision of basic statistics on the volume of requests for assistance made and received; powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted; ability to safeguard the confidentiality of information provided to OTauthorities; whether effective Memoranda of Understanding exist, where required to underpin co-operation.

Cooperation between regulatory and law enforcement authorities

The review should evaluate whether there is effective cooperation

between law enforcement authorities and financial regulators, both domestically and abroad, as specified by the G7 key 10 principles. It should also consider the ability of OT regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

MEASURES TO COMBAT MONEY LAUNDERING

The review should establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the OT to combat money laundering, and types of offences caught by the legislation. It should determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.

The review should evaluate the effectiveness and adequacy of these arrangements, in terms of how they meet the standards broadly set out in the relevant Guidance Note, which in turn refers to: 1988 UN Drugs Convention; FATF 40 Recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990), and CFATF Aruba Recommendations. Furthermore, it should consider to what extent the OTs apply standards set out by the EC Money Laundering Directive (June 1991), the standards on which UK anti-money laundering legislation is based.

Specific consideration should be given to those offences considered predicate for the purposes of money laundering legislation; whether OTs have regulatory legislation in addition to the principle money laundering offences, and if not, whether guidelines and/or Codes of Practice exist (statutory or otherwise); their systems for reporting suspicious transactions and identifying customers; the institutions obliged to report; how reports are dealt with; and within what timeframe. The review should consider how this information is disseminated and shared with foreign counterparts. It should evaluate ability of Financial Intelligence Units (FIUs), or equivalents, to deal with suspicious transactions ie. whether staff have been properly trained and capable of conducting financial investigations and analysis; the resources at their disposal; feedback to the financial institutions.

The review should determine to what extent the AttorneyGeneral's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws. This not only relates to the prosecution of cases but the provision of assistance to foreign jurisdictions in pursuance of money laundering legislation.

FORMAT OF REPORT AND TIMESCALE

FCO, HM Treasury and OT representatives will wish to agree with KPMG the precise format of the report during Phase 1 of the workplan.

KPMG should provide written monthly reports to the Steering Committee (in electronic form) and attend Committee meetings at least during Phases 1, 2 and 5 (dates to be agreed).

10 December 1999

THE SUPERVISION OF THE BANKING, INSURANCE AND SECURITIES SECTORS

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories states that the Overseas Territories (OTs) should seek to implement "*legislation for the effective regulation of the offshore sector which fully meets accepted international standards*". In many cases the OTs have already implemented some of the standards, but no attempt is made here to analyse individual territories' performance to date. Such an analysis is the objective of the independent review foreseen in the White Paper, and to attempt it in the context of this paper would result in a superficial and incomplete impression of where matters stand. Instead, the purpose of this paper is to provide an overview of the framework within which international standards relating to the regulation of banking, insurance and securities business are established, and to offer an outline of the broad standards that have evolved. The paper is not intended to act as a substitute for the study of the detailed documents published by the respective standardsetting organisations, primarily the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to these documents can be found in the following text and, specifically, in publications available on the respective websites. The following are also key documents:

Core Principles for Effective Banking Supervision	Basel Committee	Sept 1997
The Supervision of CrossBorder Banking	Basel Committee	Oct 1996
Insurance Principles, Standards and Guidance Papers	IAIS	Oct 1998
Objectives and Principles of Securities Regulation	IOSCO	Sept 1998

THE OBJECTIVES OF SUPERVISION

2. The objectives of financial services supervision fall into four broad categories:

· to secure the appropriate degree of protection for consumers of financial services;

· to maintain confidence in the financial system;

· to promote public understanding of the financial system; and

· to reduce the scope for financial crime.

3. The protection of consumers' interests does not assume an absolute objective to prevent financial consumers from losing money, but rather to create an environment where financial risk is better understood, and where there is less chance of consumers taking unnecessary and excessive risks. As stated in a recent Occasional Paper published by the UK's Financial Services Authority, this process requires "*having regard to the differing degrees of risks involved in different kinds of investment, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions*"[4]. Delivery of the appropriate environment involves both proper transparency and disclosure by financial institutions, and the effective enforcement of laws, regulations and rules by the regulators.

4. Preservation of confidence in the financial system has at its core the need to mitigate the risk of systemic failure, or of the system falling into disrepute. This will not necessarily be focused on the narrow issue of whether individual depositors or investors are threatened with the loss of money, but on whether the system as a whole might be under threat from the failure of one or more institution. There are circumstances in which individual financial institutions can and should be allowed to fail without fear of a threat to the system, even though there might be losses for the customers of those institutions.

5. The rising tide of financial crime has increasingly posed threats to the integrity of financial systems. This impacts upon both the financial stability of institutions and upon the reputation of individual jurisdictions. Although financial services supervisors are not expected to police the wider criminal laws, it is clearly important for the supervisors to play their part in reducing the exposure of the financial services sector to criminal abuse, and in tackling financial crime and regulatory abuse. This requires OT regulatory authorities to have appropriate investigative powers and specialist enforcement branches, and to cooperate fully with the authorities in other jurisdictions. The responsibility for investigating individual cases of money laundering should, however, fall to OT law enforcement authorities.

THE SUPERVISORY FRAMEWORK

6. Perhaps the single most important aspect that underpins the integrity of the financial services sector is a longterm political

commitment to effective regulation and supervision. Without such commitment the regulators will always be starved of the tools needed to achieve an effective result.

7. Fundamental to this process is a willingness to enact comprehensive regulatory legislation, to develop the associated regulations, rules and guidance, and to keep this structure under review to ensure that it stays abreast of trends both in the financial services industry itself, and in the development of regulatory practices. While the individual techniques of supervision and enforcement may vary in order to address the respective distinctive features of the offshore and domestic sectors, the fundamental standards applied to the offshore sector should not differ from those expected for the domestic market. With regard to the offshore sector, it is essential that due regard is paid to the regulatory implications in tandem with any moves taken to facilitate the development of business. Moreover, there should be no attempt to encourage "regulatory arbitrage" by seeking to offer a lighter regulatory regime than exists in competitor jurisdictions.

8. A central part of the legal framework must be provision for an effective, operationally independent and accountable regulatory authority with the appropriate powers to fulfil the objectives identified in section 2. However, legal form alone is not sufficient to provide the basis for an effective regulatory system. There needs also to be an allocation of resources in line with the structure, scale and complexity of the financial services sector. This involves an acceptance of the need to invest in the staff and infrastructure of the regulatory authority in order to ensure that it has appropriate skills and tools to meet the tasks expected of it. It has also to be recognised that there can be no formalistic approach to the funding of the regulatory regime, based, for example, on the direct benefit derived by government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision. By entering the offshore market a jurisdiction has to accept that not only does it have a duty to preserve the reputation and standing of its own financial system, but that it also assumes a wider responsibility to the international community to help ensure the integrity of the global market.

THE DEVELOPMENT OF INTERNATIONAL STANDARDS

9. The increasing internationalisation of financial services in the past decade has led to a drive to establish some common minimum standards of supervision. The application of these standards is seen as particularly important in financial centres with a high proportion of international business, since the failure of supervision there may have far wider implications than simply for the local market.

10. Standards for the supervision of the banking sector have been developed over many years under the auspices of the Basel Committee on Banking Supervision which promulgated the first Basel Concordat in 1975. In recent years there has been a rapid increase in publications emanating from Basel, many of which are intended to represent accepted international standards. Although the Basel Committee is an organisation whose membership comprises the G10 countries, it has a number of "regional" affiliates, not least of all the Offshore Group of Banking Supervisors, which have been closely involved in the development of the standards in recent years. The list of publications produced by the Basel Committee is available on the website of the Bank for International Settlements (www.bis.org). In the context of this paper the most significant of the documents are *The Core Principles for Effective Banking Supervision* (published in September 1997), which delivers 25 basic principles, and *The Supervision of CrossBorder Banking* (published in October 1996), which contains 29 recommendations.

11. In the insurance sector standards are increasingly being established by the International Association of Insurance Supervisors (IAIS). The IAIS was established in 1992 and has membership of about 100 jurisdictions, including several offshore centres. Until 1996 it had no standardsetting powers, but since that time has produced a number of standards and guidance papers. These are consolidated within the *Insurance Principles, Standards and Guidance Papers* published in October 1998. The IAIS standards focus on particular supervisory issues, describing the best or most prudent practices, while the guidance papers are designed to assist regulators to raise the effectiveness of supervision. The IAIS is in the process of developing a website which should be available shortly.

12. The primary international standards body in the securities sector is the International Organisation of Securities Commissions (IOSCO). Like the Basel Committee, IOSCO has been working over many years and published its first *Resolution on the Regulation of Securities Markets* in 1983. Unlike Basel, its membership is big (over 90 countries) and includes a large number of emerging markets and offshore centres. IOSCO's bylaws include clear objectives, with which all members are expected to comply. They include the requirements for members to cooperate, to promote high standards of regulation, to apply the standards rigorously, to establish effective surveillance and enforcement, to maintain just, efficient and sound markets, and to exchange information. In September 1998 IOSCO published its *Objectives and Principles of Securities Regulation* which sets out the 30 Core Principles of securities regulation. In addition, IOSCO has over the years produced a substantial range of other documents which represent commitments by the membership, guidance or standards,

and which are available on its website (www.iosco.org).

13. Although membership of these standardsetting organisations, or their affiliates, has been open to offshore centres, acceptance of, and compliance with the principles that the organisations espouse are essential preconditions for membership.

OVERVIEW OF THE COMMON PRINCIPLES

14. It has to be reiterated that the documents referred to in this paper are essential reading, and it is not the intention of this paper to provide a substitute summary. However, in considering the structure of the overall regulatory regimes required in the OTs it is important to identify the common themes that underpin the regulation of all three sectors. This section seeks to highlight these themes. However, it is important to appreciate that, while there are common characteristics of the regulation of the different sectors of the financial services industry, different skills and processes will be required to effect proper regulation of each sector. The reference documents address these differences.

A. General Principles

a) Regulation should be vested in a properly constituted authority which should be operationally independent from political and commercial interference in the exercise of its functions. However, it should also be openly accountable in the exercise of its powers (see also the separate paper on *Independent Regulatory Authorities*).

b) The regulatory authority should have a clear, adequate, achievable and consistent framework of responsibilities, objectives and powers set by legislation, and it should adopt processes which are fair, consistent, transparent to the public, and demonstrably geared towards achieving the objectives.

c) The regulatory authority should have adequate funding to enable it to acquire the resources (staffing, technology, infrastructure etc) to fulfil its responsibilities. The funding should be available in such form that it does not compromise the authority's independence from both political and commercial pressures.

d) The regulatory authority should have due regard to the need to compete with the commercial sector for skilled staff, and should structure its terms and conditions of employment accordingly. It should also ensure that its staff receives ongoing training.

e) The system of supervision should involve both offsite surveillance and onsite examination. This requires the regulatory authority to have the powers not only to set the scope, content and frequency of routine reporting by regulated institutions, but also to have access, whenever it considers it appropriate, to the books, records, accounts and other documents maintained by the institutions. There should be no secrecy barriers to limit the regulators' access to information.

f) The regulatory laws should establish proper licensing standards and criteria, and the regulatory authority should adopt effective procedures to ensure that applications are reviewed in a thorough and consistent manner. As a minimum this should require the implementation of comprehensive due diligence procedures in relation to controllers, directors and managers of prospective licensees, and a detailed analysis of an applicant's business plan, internal controls, projected financial condition and likely ability to comply with established prudential standards.

g) The regulatory laws should provide for notification of any intended change in ownership or control of a regulated institution, and for such changes to be subject to prior approval by the regulatory authority.

h) The regulatory authority should have the powers to implement and enforce prudential standards both generally across the entire sector, and specifically in relation to individual institutions. For example, this requires that the authority adopt and enforce suitable standards for capital adequacy, solvency, liquidity, risk concentration, asset valuation etc, taking account of accepted international standards and guidelines.

i) The regulatory authority should require institutions to maintain minimum standards of corporate governance, internal controls and operational conduct with the aim of protecting the interests of clients, ensuring proper management of risk, and accepting primary responsibility for these matters. Careful attention should be paid, for example, to the role and responsibilities of the board of directors, the arrangements for delegating authority and responsibility, the separation of duties, the safeguarding of assets and the procedures for internal audit.

j) Regulated institutions should be required to maintain proper books, records and accounts.

k) There should be procedures for dealing with the failure of a market intermediary in order to minimise damage

and loss to financial consumers and to contain systemic risk.

1) The regulatory authority should be vested with comprehensive and credible inspection, investigation, surveillance, and enforcement powers, including

- powers to take action to ensure compliance with regulatory requirements;
- powers to impose administrative sanctions for noncompliance;
- powers to initiate or refer matters for criminal prosecution; and
- powers to suspend or revoke authorisation to conduct business.

m) Regulated institutions should be subject to independent external audit in accordance with international accounting standards, and should be required to disclose to the public information regarding their activities and financial position that is comprehensive and not misleading. This information should be sufficient for financial consumers and market participants to assess the risk inherent in individual institutions.

n) The establishment of trading systems, including securities exchanges, should be subject to regulatory authorisation and oversight. Trading should be supervised in a way which ensures that the integrity of the market is maintained. There should be fair and equitable rules which strike an appropriate balance between the demands of different market participants.

o) Market regulation should promote the transparency of trading, be designed to detect and deter manipulation and other unfair trading practices, and aim to ensure the proper management of large exposures, default risk, and market disruption.

p) Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and be designed to ensure that they are fair, effective and efficient, and reduce systemic risk.

q) The regulatory system should set appropriate standards for the eligibility and regulation of collective investment schemes; provide for rules governing their legal form and structure, and for the segregation and protection of client assets; require disclosure necessary for evaluating the suitability of a scheme for particular investors; and ensure that there is a proper and transparent basis for the pricing and redemption of units.

r) The regulatory authority should have the powers and procedures to ensure that regulated institutions take action to protect themselves against criminal misuse, and that they maintain appropriate systems to comply with anti-money laundering regulations.

B. Cross-Border Issues

a) The regulatory laws and supervisory policy and procedures of a jurisdiction should seek to ensure that no institution operating across national boundaries escapes supervision, and that the supervision should be effective. In this context attention should be paid not only to corporate structures that might frustrate effective consolidated supervision (e.g. parallel-owned entities), but also to arrangements where the physical location of the licensee's mind and management differs from that of the regulator (e.g. shell branches).

b) The creation of a crossborder establishment in the regulated sector should be subject to prior consultation and agreement between the home and host regulators. This is essential not only to ensure proper assessment of the application, but also to enable both parties to agree the necessary procedures for ongoing supervision of the institution.

c) The regulatory authority should be empowered to collect both public and nonpublic regulatory information, and to share this in accordance with international principles with domestic authorities and foreign counterparts. Co-operation in the exchange of such information involves exchanges of a routine nature and the provision of assistance in an enforcement investigation, as well as in the event of the emergence of serious problems (see also the separate paper on *International Cooperation*).

d) The regulatory authority should have the powers to assist an overseas regulator in the fulfilment of its functions. This may involve assistance in obtaining information or records, but will also extend to the use of investigative or compulsory powers on behalf of the overseas regulators. Secrecy or confidentiality provisions in the law of a

jurisdiction should not be used as a means of impeding such assistance.

e) There should be no barriers to prevent a home country regulator from undertaking such procedures, and having access to such information in the host country as it considers necessary to undertake the effective consolidated supervision of an international financial services group.

THE FUTURE DEVELOPMENT OF STANDARDS

15. The rate of development of internationally recognised and accepted regulatory standards has accelerated in recent years, and further announcements should now be expected on a regular basis. Therefore, it is important to appreciate that compliance with international standards is not a static or "oneoff" process, but will require regular updating of laws, policies and procedures. With this in mind, regulatory authorities in the OTs should continue to monitor international developments, particularly where they participate in or are affected by the work of one or more of the key international standardsetters mentioned above. They should, in particular, be prepared to recommend changes in legislation where appropriate, and to implement new procedures to ensure that compliance is kept up to date. This applies in all three of the main sectors referred to in this paper.

IMPLEMENTATION

16. Standardsetting is not, by itself, enough. It needs to be accompanied by active monitoring of compliance with these standards, and the commissioning of the independent review of the OTs must be seen in the wider context. The G7 report on *International Financial Architecture*, agreed at Cologne, said:

"*With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation*."

17. The standardsetting regulatory bodies the Basel Committee, IOSCO and IAIS are now working increasingly closely with the IMF and the World Bank. In the field of banking supervision, for example, the Basel Committee, the IMF and the World Bank, working with selected supervisors around the world, have developed a *Core Principles Methodology* text which provides detailed guidance to the IMF and World Bank for their assessments of compliance. It is expected that such assessments will be made for an increasing number of countries and territories around the world; and that the results of such assessments will be used by regulators (see for instance the Basel Committee's consultative paper on a *New Capital Adequacy Framework*) and by the Washington institutions (as a precondition in the IMF's new Contingency Credit Line).

18. An IOSCO Implementation Committee, in which the IMF, World Bank and the regional development banks participate, has been set up to oversee the implementation by IOSCO members of the 30 Core Principles. Cooperation between IOSCO and the international financial institutions is at the heart of this process.

COMPANIES AND TRUSTS

1. There are legitimate reasons for using company and trust vehicles. However, the White Paper "Partnership for Prosperity" (Appendix 2, paragraph 4) states "We shall also press Overseas Territory governments to introduce legislation to improve regulation of company formation and management because, for example, in the absence of proper regulation, complex company structures can be used to disguise the proceeds of crime and other regulatory abuse as well as providing limited liability." The White Paper continues "Company formation agents and company managers need to be required by law to hold key information about the companies for which they have responsibility and to disclose that information to a regulator on request. This will ensure a properly documented paper trail for criminal and regulatory investigations."

2. This paper considers the issues of company and trust regulation relevant to the regulation of the financial system. The paper does not set out a blue-print for Company and Trust Law and regulation as a whole - that would be outside the scope of the Review, and constitute a major undertaking in its own right. The two sectors - companies and trusts - fulfil very different purposes, and their regulatory regimes have evolved in different ways, to meet different objectives. Nevertheless, in respect of their potential as vehicles for abuse, the issues raised by the trust and company sector are similar, and for this reason, this paper treats them in parallel. But the Review may wish to consider them as distinct sectors.

4. The opportunities for companies and trusts to be used for criminal purposes cannot be removed. Effective regulation can help reduce the scope for criminal abuse of such vehicles. There is no single international group of company and trust regulators. Nevertheless, the regulatory principles established by other international bodies in relation to other financial sectors apply equally well to the company and trust sectors:

The principle that financial institutions should know their customers (established by - among others - the Basle and IOSCO

standards) applies with particular relevance to situations in which the ownership of assets may be obscured through company and trust vehicles;

FATF Recommendation 11 requires financial institutions "*to take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located)*". The interpretative note to this recommendation states "*a bank or other financial institution should know the identity of its customers, even if these are represented by lawyers....accordingly, recommendation 11 also applies to the situation where an attorney is acting as an intermediary for financial services*". This accepted international standard implies that financial institutions should be able to delve beneath a corporate or trust structure, to establish the true beneficial owner and other relevant parties, and not simply the name of a lawyer acting as an intermediary.

The FATF's Recommendation 25 states "*Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities*";

International standards on accounting, disclosure and auditing practice; covering timeliness in the provision of financial information, completeness, consistency, risk management, audit and control. The relevant standards include those set by the International Accounting Standards Committee; the G22 report on transparency and accountability, October 1998; and the IMF *Guide to Progress in Strengthening the Global Financial Architecture*, April 1999). These standards are particularly relevant when there are obligations to third parties arising;

Standards of corporate governance, reflected in the *OECD Principles of Corporate Governance*, which OECD members, in co-operation with the World Bank and IMF, are committed to promoting amongst non-member countries;

The Home Office report on "*Financial Regulation in the Crown Dependencies*" (The "Edwards Report") makes specific recommendations, based on the internationally accepted principles outlined above, for the company and trust sectors of the Isle of Man, Guernsey and Jersey.

5. Satisfying these principles implies the following;

(i) Beneficial ownership.

It should be possible for law enforcement and regulatory authorities to ascertain, quickly and efficiently, and in advance of formal proceedings, the true owner of assets held by a company or trust, and the source and nature of financial transactions. It is essential to be able to trace the ultimate individual beneficial ownership of companies and to get beyond elaborate structures in which companies are owned by layers of other companies and/or trusts, which obscures the ultimate owner.

In the company sector, this would involve the OT authorities having the means to identify company directors and the beneficial ownership of shares, eg where nominees exist. Effective custody arrangements would need to be in place in relation to bearer shares. In the trust sector, OT authorities should have the means to be able to identify the settlor, the beneficiaries, the trustees, the protector, and the custodian, where applicable, and should be able to obtain a copy of the trust instrument. This would help identify 'sham' trusts, for example. OT authorities should have the means to obtain up-to-date information, and to obtain such information in relation to companies and trusts which might be established in other jurisdictions, yet which might be managed or move to the OT concerned.

(ii) Anti-money laundering systems.

Intermediaries providing corporate or trust services should have in place effective anti-money laundering measures, including "know your customer", record keeping, and staff training requirements. Suspicious transactions involving companies and trusts should be disclosed to a Financial Intelligence Units. (More details on anti-money laundering standards are set out in the 'Money Laundering Guidance Note').

(iii) Transparency of financial arrangements.

Basic financial information relevant to the activities of companies and trusts should be available, quickly and efficiently, and in advance of formal proceedings, to law enforcement and regulatory authorities. Ideally, such information in the company sector should also be available to customers, shareholders, suppliers and lenders, where appropriate. In the trust sector, trustees should ideally be held accountable to the beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector where applicable.

The Review will wish to consider in which circumstances it would be appropriate to require accounts to be produced, in which circumstances such accounts should be made public, in which circumstances abbreviated accounts might be acceptable, and in which circumstances the requirement to produce accounts should not be applied. The latter might apply where single asset holding vehicles exist with no third party involvement.

(iv) Obligations on directors, trustees, and company and trust service providers.

Measures should be in place to ensure that directors and trustees fulfil their "due diligence" obligations effectively, and to prevent nominees from assigning their responsibilities to others through general powers of attorney, and being used as a cover for criminal activities and regulatory breaches. More generally, those who provide corporate and trust services should be licensed, and subject to effective regulation. The "four eyes" principle should apply. The codes which apply to company and trust managers should be complementary, for example to avoid a situation in which inter-linking ownership of company and trust vehicles can be used to obscure beneficial ownership. OT authorities should be able to identify the true directors and owners of a company, and the settlors, beneficiaries, trustees, protectors, and custodians of a trust. The rules, regulations, and laws relating to insolvency and bankruptcy should also be examined by the Review, to ensure that these may not be abused, eg for the purpose of defrauding shareholders.

(v) Investigative and enforcement powers.

OT authorities should be able to apply full investigative powers to those (eg directors, beneficial owners, settlors, beneficiaries, trustees, nominees) who are suspected of criminal activity. This extends to applying the compulsory powers referred to in the paper on 'International Co-operation'. OT authorities should be able to identify the links which may exist between companies and trusts. OT authorities should launch appropriate investigations in the face of bankruptcy and insolvency. More generally, the regulation of company and trust service providers and formation agents needs to be accompanied by effective and independent enforcement powers, including the power to monitor and supervise licensed formation agents and service providers, to inspect their activities, to investigate potential breaches of rules, regulations, and laws, and to take appropriate enforcement action. The latter would include the ability and willingness to take disciplinary action (eg remove licences) as well as to pursue civil and criminal sanctions.

(vi) Removal of impediments to asset tracing and seizure.

Trust and company arrangements should not be able to be used to frustrate the due process of law in attempts to trace and seize assets.

INDEPENDENT REGULATORY AUTHORITIES

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories explains that one of the "key components of the regulatory package we wish to see in place by the end of 1999" is "the establishment of independent regulatory authorities meeting accepted international standards". The Financial regulation checklist appended to the White Paper provides further detail on what this amounts to.

2. Four publicly available papers provide more specific details on what the international community expects from a regulatory authority. These documents are (i) "Objectives and Principles of Securities Regulation" by the International Organisation of Securities Commissions; (ii) "Core Principles for Effective Banking Supervision" by the Basle Committee on Banking Supervision; (ii) "The Supervision of Cross-Border Banking" by the Basle Committee on Banking Supervision and the Offshore Group of Banking Supervisors; (iv) "Insurance Principles, Standards and Guidance Papers" by the International Association of Insurance Supervisors.

KEY FEATURES

(i) Independence

3. Independence is required in order to generate confidence, in particular that all market participants will be treated objectively and fairly, and that rules and regulations will be applied uniformly in such a way as to protect investors and promote orderly market activity. These objectives will not be satisfied unless the regulatory authority is clearly seen to act independently, and to have sole responsibility for regulating market activity.

4. The concept of independence does not imply that regulatory authorities are unaccountable. Instead, it implies that their

day to day operations should be free from political or commercial control and influence. These executive operations include all the regulator's key functions, such as (a) deciding to issue, suspend, and withdraw licences; (b) supervising and inspecting the activities of licence holders, including issuing rules and regulations; (c) undertaking investigations; (d) taking enforcement action, and; (e) co-operating with overseas authorities. The regulatory authority should have the necessary powers and ability to regulate all licensed activity.

5. Proper independence requires the regulatory authority to exist as a stand-alone body, rather than as eg a separate unit within the Finance Ministry. Independent regulatory authorities are typically established by statute, which sets out the authority's powers and responsibilities. Those working in the authority, including senior management, should not have any external commercial or political interests or responsibilities (including unpaid directorships). The regulatory authority should not be required to secure OT government approval before exercising its executive powers.

6. Independence extends to the authority's functions. The regulatory authority should not be charged with any political or commercial responsibilities. In particular, the authority should not seek to market its jurisdiction as a place for business to locate. All such hard selling and marketing should be undertaken by a separate body which is not connected in any way with the regulatory authority (again, members of staff should not work in both bodies). Such separate promotional bodies should not be funded by the regulatory authority. Essentially, the job of selling the merits of doing business in a particular OT should be left either to OT governments or to the private sector. It would, however, be open to the regulatory authority to provide information about the regulatory regime in the jurisdiction to potential inward investors.

7. Independence extends to the way in which the authority is resourced. Regulatory authorities should be self-supporting and have their own source of income, independent from Government control. This is often raised through licence fees or another form of industry levy. Where these fees currently account for a large proportion of OT government income, the authority would return any excess income to the government.

8. Independence does not imply isolation. The regulatory authority should consult both the industry and the OT government before seeking to make any changes to broad regulatory policy, and before seeking to make changes which have national policy implications, or which have significant implications for the industry. These implications can properly include considerations of internal and external competitiveness, within the parameters of relevant international standards.

(ii) Accountability

9. Independent regulatory authorities are subject to a number of checks and balances, which in turn ensure that they are held accountable for their actions. In particular;

(a) Statutory objectives. The objectives of the authority should be laid down by statute drawn up by the OT Government. These objectives should reflect the need to satisfy internationally accepted standards of regulation.

(b) Appointments. The authority should operate under a properly constituted board or Commission, which holds a mix of relevant expertise. All board/Commission members should be appointed on the basis of that expertise by the OT Government, or by the Governor in consultation with the OT Government (eg where the Governor retains responsibility for the offshore sector). All key policy decisions should be approved by the board.

(c) Legislation. Legislation covering financial regulation as a whole will often need to be amended or introduced in order to make any significant changes to the regulatory regime. Regulatory authorities do not normally have the power to make such legislation, and will need the support of those who do if significant changes are to be made to the regulatory regime.

(d) Annual report. The authority should produce an annual report available to the public explaining its operations over the past year, how its objectives have been tackled, how resources have been allocated, and how it intends to tackle its objectives in future. This would include publishing a set of audited accounts and possibly a Statement of Principles. The annual report should identify where problems have been encountered in meeting international standards, and how the authority intends to deal with these problems. OT Governments should question the authority in relation to its annual report.

(iii) Functions and powers

10. The documents mentioned in paragraph 2 provide full detail on the types of function expected of a regulatory authority. For the purposes of this paper, it is worth noting simply that the regulatory authority should have sole responsibility and powers in the following areas. These functions relate to the regulation of activity;

(a) Licensing. The regulatory authority should have sole responsibility for issuing, suspending, and withdrawing licences. This extends to having the powers and ability to investigate whether persons are 'fit and proper' to work for a licensed firm.

(b) Determining how licensed firms and persons should conduct business. The regulatory authority should have sole responsibility for setting conduct of business rules and regulations, and providing guidance for market practitioners. Where legislation is required, the authority should be able to make proposals to OT governments.

(c) Supervising and monitoring licensed activity. The regulatory authority should monitor all licensed activity. This would involve establishing regular (eg quarterly) reporting systems plus a programme of regular and 'surprise' inspections. The regulatory authority should not require the prior approval of any external body before conducting such inspections.

(d) Investigating. The regulatory authority should conduct in-depth investigations into suspected breaches of rules, regulations, and laws. The regulatory authority should have the power to compel the production of information from both licensed and unlicensed firms and persons, in the ways outlined in the paper on 'International Co-operation'. In particular, the regulatory authority should not pursue criminal investigations outside the regulatory function - the law enforcement authorities should be responsible for leading those investigations.

(e) Taking enforcement action. The regulatory authority should have the powers to take appropriate enforcement action in response to breaches of rules, regulations, and laws. This would include the ability to suspend and withdraw licences, the ability to issue directions, and the ability to levy fines. Where criminal activity is encountered, lead responsibility for taking enforcement action would normally fall to the law enforcement authorities in conjunction with the prosecuting authorities.

(f) Co-operating with other authorities. Where serious breaches are encountered, the regulatory authority would be expected to co-operate fully with other authorities within the OT, such as prosecuting and law enforcement authorities. This would essentially involve the regulatory authority handing over information it had obtained before it became clear that criminal activity was at hand, rather than the regulatory authority undertaking any criminal investigations. OT authorities should also co-operate fully with authorities based overseas, in the ways outlined in the paper on 'International Co-operation'.

(iv) Resources

11. The regulatory authority should be properly resourced in order to meet these responsibilities effectively, and a certain critical mass is required. This includes having access to legal and accountancy advice from sources which do not suffer from a conflict of interest. Regulatory authorities should have their own source of stable ring-fenced income, independent from Government or other political control and influence. This income is often raised from the industry in some way.

12. As stated in the paper 'The Supervision of the Banking, Insurance, and Securities Sectors', resources should be allocated 'in line with the structure, scale, and complexity of activity. The funding of the regulatory regime should not be based on the direct benefit derived by the OT Government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision'.

(v) Liabilities

13. Regulatory authorities are normally subject to statutory immunity from prosecution, in order to allow them to conduct their regulatory functions more effectively. Other jurisdictions are more likely to recognise this immunity if the regulatory authority matches up to international standards, in the ways outlined above. The converse is also true.

14. Properly resourced regulatory authorities which perform their functions in the ways envisaged by the documents mentioned in paragraph 2 are also much less likely to get into the sorts of situation where their actions might be subject to legal challenge. For example, the regulatory authority should be able to demonstrate that any problems did not arise as a result of substandard regulation.

INTERNATIONAL CO-OPERATION

INTRODUCTION

1. By their very nature, offshore centres conduct business which is linked with that in other financial centres. For this reason, it is important that offshore centres cooperate fully with requests for assistance from authorities in other jurisdictions. This includes both regulatory and law enforcement authorities. The types of assistance referred to in this paper do not include co-operation relating to fiscal matters.

2. The White Paper on Britain and the Overseas Territories explains that one of "the key components of the regulatory package we wish to see in place by the end of 1999" is "powers to ensure that, whatever the secrecy laws, regulators and law enforcement in those Overseas Territories with financial sectors can cooperate properly with their overseas counterparts, including on investigation and enforcement matters".

3. Assistance should extend to;

(i) Regulatory authorities sharing confidential regulatory information held on file or obtainable from licensed bodies.

(ii) Regulatory authorities obtaining information by compulsion from unlicensed bodies, and obtaining client information by compulsion from licensed bodies (where clients refuse to disclose this information voluntarily).

(iii) All such exchanges of information between regulatory authorities to take place under cover of a bilateral Memorandum of Understanding signed by each party, setting out the terms and conditions of assistance, including that the confidentiality of information provided must be safeguarded.

(iv) Law enforcement authorities providing assistance to their foreign counterparts covering all financial crimes (not just those related to money laundering or drugs-related offences), extending to investigative assistance before court proceedings have been issued, and providing for evidence to be obtained on their behalf.

(v) OT regulatory authorities allowing information disclosed to a foreign regulatory authority to be disclosed in turn by them to a foreign law enforcement authority, but only with the OT's prior consent, which may extend to placing conditions on how that information might be used.

GATEWAYS: A PRECONDITION FOR INFORMATION EXCHANGE

4. Where confidential information is exchanged with a foreign authority, or between different authorities within the same jurisdiction, confidentiality should be safeguarded. Confidential information should only be exchanged where provided for in law. Confidential information should only be passed to *bona fide* authorities which can safeguard its confidentiality, and these safeguards should be established in law. Similarly, legislation in Overseas Territories should provide OT authorities with the power to safeguard the confidentiality of information they may have received from foreign authorities.

5. All Overseas Territories should have in place statutory 'gateways' which enable confidential information to be exchanged with foreign authorities. This would include all forms of information of interest to the authorities, including information relating to individuals, bank accounts, trusts, and companies. 'Gateways' legislation should override any secrecy and confidentiality provisions in OT law, to the extent that it should allow confidential information from all sources to be passed to a foreign authority, as long as that authority could in turn safeguard its confidentiality.

6. It is possible that foreign regulatory authorities might be compelled by Court order in their country to disclose confidential information obtained from an OT authority. In these circumstances, the OT authority's prior consent should be sought before any confidential information is disclosed to the Court. If such consent is not forthcoming, the Court should be made aware by the foreign authority that any compulsion to disclose may damage relations between regulatory authorities, to the detriment of future regulatory co-operation, and that this would not be in the public interest.

CO-OPERATION BETWEEN REGULATORY AUTHORITIES

(i) Types of co-operation

7. Gateways *per se* do not provide for adequate co-operation. They simply allow confidential information to be exchanged. Gateways need to be supplemented by powers which enable OT authorities to obtain information (either for their own purposes, or on behalf of foreign authorities), and subsequently to exchange this with foreign authorities.

(i) Supervisory information

8. OT regulatory authorities should be able to obtain, in the course of their normal duties, information relating to the supervision of licensed firms and persons. OT regulatory authorities should be able to exchange this information with their foreign counterparts.

(ii) Voluntary testimony

9. Representatives from a foreign regulatory authority should be allowed to visit an OT with the consent of the OT regulator, and take testimony from individuals and firms who voluntarily consent to being questioned by a foreign regulatory authority. Before approving a request to take voluntary testimony, the OT regulator should be satisfied (i) that the request comes from a *bona fide* foreign regulatory authority, and relates to their regulatory responsibilities, (ii) that the request relates to a specific line of investigation, and (iii) that the confidentiality of any information provided will be safeguarded.

(iii) 'Compulsory' powers

10. These are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT. Following discussions at the past three Attorney Generals' Conferences, a draft Model Ordinance providing for compulsory powers is now well developed (attached at Annex B).

11. Annex A provides more details on how these powers would operate in practice. Because individuals and firms are *compelled* to provide information, there are tight constraints and conditions on the use of these powers, and OT regulatory authorities would have discretion in deciding whether to use them on behalf of an overseas authority. It is worth noting here that;

(i) Compulsory powers should only be used in certain specific circumstances. Incoming requests for information, which will require the use of OT compulsory powers to obtain it, should be vetted by the regulatory authority's lawyers (or an OT Magistrate/Court) within a specific time frame, in order to verify that compulsory powers may be used. Information obtained by compulsion may also be vetted by the regulatory authority's lawyers before final disclosure to a foreign authority;

(ii) Information obtained by compulsion should not be used as evidence against the provider in any subsequent criminal proceedings. The OTs will wish to decide whether to preclude it being used as criminal evidence against third parties;

(iii) Compulsory powers are used only at the very early stages of an investigation, when the investigator does not know whether criminal activity is at hand. Compulsory powers should no longer be used if/when it becomes clear that only criminal activity is involved, and hence that the investigation should be taken forward by the law enforcement authorities (once a suitable request for assistance has been made through other channels);

(iv) Strict terms and conditions on the use of compulsory powers should ensure that they cannot be abused to go on 'fishing trips', that the Overseas Territories retain discretion over their usage, and that they should not be used when it would be more appropriate to go though other channels (eg Mutual Legal Assistance Treaties (MLATs)).

12. Subject to these conditions, information obtained by compulsion may be disclosed to the law enforcement authorities, who as a result may seek to obtain criminal evidence (via other channels). Information obtained by compulsion may help indicate where criminal evidence may be obtained, ie may lay the ground for further requests for assistance via other channels by foreign law enforcement authorities.

13. In summary, these powers are used to uncover facts during the very early stages of an investigation, before it is clear what has taken place, in order to gain a picture of what happened. When it has become clear what happened, the authorities may choose whether to take no action, whether to take disciplinary action, whether to consider civil proceedings, or whether to consider criminal proceedings. Criminal evidence would need to be obtained via other channels (ie agreements between law enforcement authorities) in order to pursue a criminal prosecution. In the UK's experience, compulsory powers are rarely used on behalf of a foreign authority (about ten times per year).

(ii) Memoranda of Understanding

14. It is common practice between regulatory authorities for the terms and conditions of information exchange and

investigative assistance to be set out in a Memorandum of Understanding signed between the authorities which will be co-operating with each other. Memoranda of Understanding usually require requests for assistance to be framed in terms of the specific activities which are being investigated by the foreign jurisdiction - eg they can prevent authorities going on 'fishing trips' in another jurisdiction.

15. Memoranda of Understanding should only provide for the exchange of confidential information when the foreign regulatory authority has demonstrated that they will be able to safeguard the confidentiality of information provided by the OT regulator. Memoranda of Understanding should specify explicitly how confidentiality will be safeguarded, and should set out the terms and conditions of onward disclosure, eg to a foreign law enforcement authority. It is common to allow a foreign regulatory authority to disclose information obtained (eg from an OT regulator) to another foreign authority, but only with the consent of the OT regulator in this example. Memoranda of Understanding should specify what terms and conditions apply to the use of compulsory powers, and this may include specifying how information provided may be used.

16. Memoranda of Understanding are not legally binding documents, nor are they any form of legislation. They are simply an agreement between two regulatory authorities. For this reason, they tend to be tailored to the degree and nature of assistance available in each jurisdiction. Separate MoUs tend to apply to each sector (ie banking, securities, and insurance), although eg an MoU in the securities field would still provide for the exchange of information on bank account details (where this was connected to a breach of regulations or laws concerning securities).

17. Further precise details on international standards relating to Memoranda of Understanding are set out in publications by the Basle Committee, IOSCO, and the IAIS. The IAIS paper 'Insurance Principles, Standards, and Guidance Papers' includes in an Annex a model MoU in the field of insurance. IOSCO have published separate guidance titled 'Principles for Memoranda of Understanding'.

18. An Overseas Territory regulatory authority may still exchange information with a foreign authority if a Memorandum of Understanding is not in place. The terms and conditions of such exchange would need to be agreed on a case by case basis. Memoranda of Understanding essentially provide a framework which allows information to be exchanged without the terms and conditions of such exchange having to be negotiated on each separate occasion. Memoranda of Understanding are therefore more relevant between jurisdictions which exchange regulatory information regularly.

CO-OPERATION BETWEEN LAW ENFORCEMENT AUTHORITIES

(i) Types of co-operation

19. Assistance should be available to foreign law enforcement authorities in relation to all forms of financial crime, rather than just drugs-related offences or money laundering. This would include fraud, insider-dealing, and market manipulation. An OT should be able to provide assistance even though the activity under investigation might not be a criminal offence in that OT. In these circumstances, OT law enforcement authorities will wish to consider whether there is a good reason to provide assistance, or whether it would be in the public interest not to provide assistance.

20. OT law enforcement authorities should be able to provide investigative assistance, and should be able to obtain evidence on behalf of their foreign counterparts. As with regulatory co-operation, assistance should be provided in response to specific requests. Investigative assistance should be made available before court proceedings have been issued, and ideally without the prior need for a Treaty to exist between the countries in question.

21. These objectives would be satisfied if the Overseas Territories were to adopt measures equivalent to those in the UK's Criminal Justice (International Co-operation) Act 1990, which provides for UK authorities to co-operate with judicial and prosecuting authorities in other countries in criminal proceedings and investigations. Many OTs have already introduced equivalent legislation. It is for OTs to decide whether they wish to satisfy the objectives specified here by adopting equivalent legislation or by choosing other means. It is worth noting here that assistance should be available to all *bona fide* foreign law enforcement authorities with genuine requests.

22. It is not common for Memoranda of Understanding to be signed between law enforcement authorities, if only because the types of co-operation required are often provided for by international Treaties. Nevertheless, there is nothing to prevent Memoranda of Understanding from being adopted, especially if OT law enforcement authorities wish to adopt bilateral agreements specifying exactly how assistance might be provided.

23. Memoranda of Understanding are generally easier and quicker to devise and modify than bilateral Treaties. For this reason, an OT is unlikely to be able to co-operate effectively in the ways envisaged with a wide range of countries over a wide range of areas if it seeks to negotiate, sign, and manage a set of bilateral Treaties with all foreign law enforcement

authorities which seek assistance.

(ii) Seizing assets

24. International co-operation should extend to tracing, freezing, and confiscating the proceeds of crime, and their value, on behalf of overseas authorities. Powers to trace assets for authorities in other jurisdictions should be exercisable regardless of banking secrecy and, preferably, on an agency to agency basis as well as through central authority channels. Powers to restrain and confiscate assets which represent the proceeds of crime should be on an all crimes basis, as envisaged in the 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime.

25. No assets should be immune from seizure, either by virtue of OT laws or other arrangements providing for asset protection, or by virtue of arrangements (eg in trust instruments) which require assets to 'flee' to another jurisdiction when there is a chance that they might be seized. These arrangements for asset seizure should apply to all financial crimes, ie not just drugs-related crimes or money-laundering, even though a crime may not have been committed in an OT.

CO-OPERATION BETWEEN DIFFERENT TYPES OF AUTHORITY

26. The G7 have recently adopted a set of ten principles concerning the extent to which regulatory and law enforcement authorities should work with each other, including when different types of authority are based in different jurisdictions. In general, different types of authority (regulatory and law enforcement) should be able to exchange information with each other and to provide each other with investigative assistance, subject to specific terms and conditions set out in Memoranda of Understanding. This does not imply that regulatory authorities should take on the role of 'international tax policemen'.

27. In practice, an OT regulatory authority would assist a foreign law enforcement authority by passing information to a foreign regulatory authority, and allowing them (with prior consent) to disclose this to a law enforcement authority in their jurisdiction. Domestic regulatory authorities do not tend to deal directly with foreign law enforcement authorities. If this arrangement is to work effectively, there need to be effective gateways and working relations between regulatory and law enforcement authorities in the same jurisdiction.

28. This should not, however, prevent OT regulatory authorities from dealing directly with foreign regulatory authorities which also happen to possess certain law enforcement and prosecuting responsibilities. In this instance, the Memorandum of Understanding between respective regulatory authorities would need to specify clearly how any information disclosed might be used.

ANNEX A: COMPULSORY POWERS (OR INVESTIGATIVE POWERS)

A1. Compulsory powers are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. In the context of regulatory co-operation, OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT.

A2. Compulsory powers may be used to obtain information from both licensed and unlicensed firms and persons. This includes ordinary members of the public as well as all financial institutions, companies, and trusts. Compulsory powers may be used to obtain all types of information, including details of beneficial ownership, personal bank details, and personal telephone records.

A3. Compulsory powers override all other secrecy and confidentiality provisions in law - ie they may be used to obtain information from bank accounts, companies, and trusts, even if other laws declare that all such information should not be disclosed. Confidential information would only be disclosed to a foreign regulatory authority if they could safeguard its confidentiality.

Use of compulsory powers

A4. These wide-ranging powers are used at the very early stages of an investigation to gain an understanding of what happened - ie which activities took place where, and who was involved with what. Compulsory powers are used infrequently, as regulatory authorities normally have a clear understanding of what happened, especially where 'know your customer' guidance is actively implemented and licensed firms and persons are willing to assist the authorities.

A5. Compulsory powers are used to undertake fact finding investigations, rather than to obtain criminal evidence. Information obtained by compulsion may be used by the regulator to take disciplinary or civil action. Because information is obtained by compulsion, it cannot be used as evidence in criminal proceedings against the provider.

A6. Furthermore, the 'rules of evidence' which exist in most countries normally prescribe how evidence may be obtained, and this tends to involve questioning under police caution: ie the very nature of compulsory powers normally prevents any information obtained from being used as evidence in criminal proceedings. OT regulatory authorities may in addition wish to specify in Memoranda of Understanding signed with foreign counterparts that information obtained by compulsion cannot be used as evidence in criminal proceedings.

A7. Compulsory powers should not be used to provide assistance to a foreign regulatory authority if it would be more appropriate to use other channels (eg Mutual Legal Assistance Treaties (MLATs)). It is for the requested authority to determine the appropriate channels in line with commitments entered into in any MoUs or Treaties. In practice, compulsory powers should only be used when it remains possible that civil action may be taken as a result of the investigation at hand. As soon as it becomes clear during the investigation that the authorities are faced with only criminal activity, compulsory powers should no be longer used. At this stage, the law enforcement authorities should be left to pursue a criminal investigation (and overseas law enforcement authorities should seek assistance via other channels).

A8. Within this framework, compulsory powers can still be used to assist law enforcement authorities, but only at the very early stages of an inquiry, when it remains unclear what happened, and hence whether civil or criminal sanctions (or none) would be appropriate. Information obtained by compulsion essentially lays the ground for criminal investigations undertaken by law enforcement authorities, should it transpire that criminal activity is at hand. Compulsory powers would be used before a foreign law enforcement authority is in a position to make a request for assistance from an OT law enforcement authority (eg via MLAT).

A9. In this limited sense, the use of compulsory powers may lead to criminal prosecutions. In practice, an OT regulatory authority would not deal directly with a foreign law enforcement authority. Instead, OT regulatory authorities would deal with their foreign counterparts, and then allow (with prior consent) their foreign counterparts to disclose information received to foreign law enforcement authorities.

Who investigates?

A10. Investigations are usually undertaken by the domestic regulatory authority on behalf of the overseas regulator. It is normal for these powers to be vested with the head of the regulatory authority, although an alternative may be to vest them with the Governor or Minister of Finance (depending on who is ultimately responsible for regulation of the offshore sector).

A11. Whoever holds these powers may authorise an officer of his or any other competent person to exercise them. If an OT so wishes, it is possible for an OT regulator to allow an overseas regulator to operate as an authorised agent of theirs and use these powers directly. The decision on who to appoint is normally made on a case by case basis.

A12. Payment of the costs of exercising these powers can be made a condition for providing assistance. This normally happens when the balance of requests tends to be one-sided, rather than domestic and overseas authorities seeking broadly equivalent assistance from each other.

Constraints and discretion in exercising compulsory powers

A13. The exercise of investigative powers after a request is not inevitable, nor is the disclosure of information obtained by their exercise. The powers can only be used to assist an overseas authority having specified regulatory functions, and then only for the purposes of those functions. Assistance should be provided when there is a good reason to do so (this hurdle is normally relatively easy to satisfy).

A14. The information which is obtained through the exercise of investigative powers can be disclosed only if a gateway exists. If there are concerns about how the confidentiality of the information provided will be safeguarded once in the hands of the overseas regulator, or if, as a result of the investigation, doubts have arisen about the authenticity of the overseas regulator's claim to need the information for its regulatory functions, the OT regulatory authority should discuss its concerns with the foreign regulatory authority before disclosing any information.

A15. Assistance should be provided in response to individual requests, which should specify what information is sought and the purpose for which it is sought, including details of the laws, rules or regulations which it is alleged have been breached and of the conduct which gives rise to the breach. The draft model OT Compulsory Powers Ordinance (attached) requires that the following factors be taken into account when deciding whether to exercise compulsory powers on behalf of a foreign authority;

Whether corresponding assistance would be given to the OT;

Whether the inquiries relate to a breach of law which has no parallel in the OT (although assistance may still be provided in these circumstances, if there is a good reason to do so);

The seriousness of the matter in question, the importance to the investigation of exercising compulsory powers, and whether assistance could be obtained by other means (eg MLATs);

Whether it is in the public interest to provide assistance.

A16. Each request for assistance should be vetted by the OT regulatory authority to ensure that it is made by a foreign authority which has the necessary functions and that the request is made for the purpose of its regulatory functions. The requesting authority must demonstrate that a substantial line of enquiry is being pursued - its request should not be a "fishing trip" for information. In practice, the OT regulatory authority would also vet all information obtained by compulsion, to ensure that information disclosed to a foreign authority relates to the specific request made. This vetting would normally be undertaken by the OT regulatory authority's legal advisers. The draft model OT Compulsory Powers Ordinance also provides for an OT Magistrate or Court to approve the use of compulsion, within a short time frame. Under the draft model OT Compulsory Powers Ordinance, it is a criminal offence not to provide information under the exercise of compulsory powers.

ANNEX B: DRAFT COMPULSORY POWERS MODEL ORDINANCE

A Bill entitled:

An Ordinance to make provision for assisting overseas regulatory authorities to obtain information:

ENACTED BY the Legislature of [the Caribbean Overseas Territory] as follows:

1. This Ordinance may be cited as the ******** Ordinance, 1998.

2. In this Ordinance:

"competent authority" means any authority specified in [the Schedule to this Ordinance] [an Order made by the Governor];

["Director" means the Director of Financial Services;]

"foreign regulatory authority" means an authority which, in a country or territory outside [the Caribbean Overseas Territory], exercises functions corresponding to any functions of a competent authority under any Ordinance, or exercises any function [prescribed for the purposes of this section by an Order made by the Governor, being a function] which in the opinion of the Governor relates to companies or financial services;

"Governor" means the Governor in Council;

"regulatory functions" means functions of a competent authority under any Ordinance or any functions corresponding to such functions, and any other functions relating to companies or financial services, not being the functions of assessing, imposing or collecting taxes.

3. (1) Subject to subsection (2), the powers conferred by section 4 are exercisable by the [Director] for the purpose of assisting a foreign regulatory authority which has requested assistance in connection with inquiries being carried out by it or on its behalf.

(2) The [Director] shall not exercise the powers conferred by section 4 unless he is satisfied that the assistance requested by the foreign regulatory authority is for the purposes of its regulatory functions.

[(2A) The [Director] may decline to exercise the powers conferred by section 4 unless he is satisfied that information furnished pursuant to the exercise of those powers will not be used in any criminal proceedings against the person furnishing it (other than proceedings for an offence under section 7 or for an offence of perjury, or for any like offence).]

(3) In deciding whether to exercise those powers, the [Director] may take into account, in particular:

(a) whether corresponding assistance would be given in the relevant country or territory to an authority exercising regulatory functions in [the Caribbean Overseas Territory];

(b) whether the inquiries relate to the possible breach of a law, or other requirement, which has no close parallel in [the Caribbean Overseas Territory] or involves the assertion of a jurisdiction not recognised by the [the Caribbean Overseas Territory];

(c) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in [the Caribbean Overseas Territory] and whether the assistance could be obtained by other means;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

[(4) For the purposes of subsection (3)(a), the [Director] may require the foreign regulatory authority requesting assistance to give a written undertaking, in such form as the [Director] may determine, to provide corresponding assistance to an authority exercising regulatory functions in [the Caribbean Overseas Territory].

(5) Where a foreign regulatory authority fails to comply with a requirement made under subsection (4), the [Director] may refuse to provide the assistance sought.]

(6) The [Director] may decline to exercise the powers conferred by section 4 unless the foreign regulatory authority undertakes to make such contributions towards the costs of their exercise as the [Director] considers appropriate.

(7) In subsection (3)(a), "relevant country or territory" means the country or territory from which the request for assistance is made.

4. (1) Where in accordance with section 3 the [Director] is satisfied that assistance should be provided pursuant to a request by a foreign regulatory authority, he may in writing direct any person -

(a) to furnish him with information with respect to any matter relevant to the inquiries to which the request relates;

(b) to produce any documents relevant to those inquiries; or

(c) to give him such assistance in connection with those inquiries as the [Director] may specify.

[(3) The [Director] may examine a person on oath and may administer an oath accordingly.]

[(3A) Where a person fails to comply with a direction given under subsection (1) within three days from the date of the direction or such longer period as the [Director] may permit, the [Director] may apply to [a Magistrate] [the court] for an order requiring the person to comply with the direction.

(3B) Where pursuant to a direction given under subsection (1) the [Director] considers it necessary to examine a person on oath, [the Director] may apply to [a Magistrate] [the court] to have that person examined by [the Magistrate] [the court] and the results thereof transmitted to the [Director].

(3C) [A Magistrate] [the court] shall process an application under subsection (3A) or (3B) within seven days and, in the case of subsection (3B), [he] [it] shall transmit the results of the examination to the [Director] within a reasonable period not exceeding fourteen days.]

(4) Where documents are produced pursuant to this section the [Director] may take copies or extracts from them.

(5) A person shall not under this section be required to disclose information or produce a document which he would be entitled to refuse to disclose or produce on grounds of legal professional privilege in proceedings, except that a [lawyer] [barrister or solicitor] may be required to furnish the name and address of his client.

(6) Where a person claims a lien on a document, its production under this section is without prejudice to his lien.

(7) In this section "documents" includes information recorded in any form; and, in relation to information recorded otherwise than in legible form, the power to require its production includes power to require the production of a copy of it in legible form.

5. (1) The [Director] may:

(a) [seek the assistance of the Commissioner of Police in the exercise of his powers under this Ordinance; or]

(b) authorise an officer of his or any other competent person to exercise any of those powers.

(2) No such assistance shall be sought or authority granted except for the purpose of investigating -

(a) the affairs, or any aspect of the affairs, of a person specified by the [Director]; or,

(b) a subject matter specified by the [Director];

being a person who, or a subject matter which, is the subject of the inquiries being carried out by or on behalf of the foreign regulatory authority.

(3) No person shall be bound to comply with a requirement imposed by a person exercising powers by virtue of an authority granted under this section unless he has, if required, produced evidence of his authority.

(4) Where the [Director] seeks assistance or grants an authority under subsection (1), the assistance or authority shall be provided or executed in such manner as the Director may determine; and where the Director grants such an authority to a person other than one of his officers, that person shall make a report to the [Director] in such manner as he may require on the exercise of that authority and the results of exercising it.

6. (1) No information which

(a) is supplied by a foreign regulatory authority in connection with a request for assistance, or

(b) is obtained by virtue of the exercise of powers under this Ordinance, shall, except as permitted by subsection (2), be disclosed for any purpose by the primary recipient, or by any person obtaining the information directly or indirectly from him, without the consent of the person from whom the primary recipient obtained the information and, if different, the person to whom it relates.

(2) Information to which subsection (1) applies may be disclosed:

(a) to any person with a view to the institution of, or otherwise for the purpose of:

(i) criminal proceedings;

(ii) disciplinary proceedings relating to the exercise by a barrister, solicitor, auditor, accountant, valuer or actuary of his professional duties;

(iii) disciplinary proceedings relating to the discharge by a public [servant] [officer] of his duties;

(b) for the purpose of carrying out any duty imposed under any law in force in [the Caribbean Overseas Territory] or by any international agreement to which [the Caribbean Overseas Territory] is a party;

[(c) on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings;]

(d) for the purpose of enabling or assisting a competent authority to discharge any of its functions under any Ordinance;

(e) to the [Governor/Attorney General/public officer approved by the Director] [in the public interest];

(f) if the information is or has been made available to the public from other sources;

(g) in the form of a summary or collection of information framed in such a way as not to enable the identity of any person to whom the information relates to be ascertained;

(h) to a foreign regulatory authority for the purpose of its regulatory functions.

(3) In subsection (1) "the primary recipient" means, as the case may be -

(a) the [Director];

(b) any person authorised under section 5; or

[(c) the Commissioner of Police or any of his officers.]

7. (1) A person who

(a) without reasonable excuse, refuses or fails to comply with any [direction given by the [Director]] [order of [a Magistrate] [the court]] under section 3;

(b) intentionally furnishes false information in purported compliance with any such [direction] [order];

(c) with intent to avoid the provision of this Ordinance, destroys, mutilates, defaces, secretes or removes any document;

(d) otherwise wilfully obstructs any inquiry to which a request from a foreign regulatory authority relates; or

(e) contravenes section 6;

commits an offence.

(2) A person who commits an offence under this section is liable .....

8. No suit shall lie against the [Director] or any person acting under his authority for anything done by him, in good faith, in the exercise of any power or the performance of any function under this Ordinance.

9. This Ordinance shall come into [force] [operation] on such date as the Governor may by proclamation appoint.

MONEY LAUNDERING

INTRODUCTION

1. Money laundering is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises. It is, in effect, the interface between the illegal business sector and the financial sector. Estimates of the size of the phenomenon are hard to come by, but it is generally agreed that it could be in the region of 5% of GDP of the average country.

2. The activity is one of considerable concern for many reasons. If the proceeds of crime are allowed to be lodged unhindered in financial institutions, criminals can gain influence over the institutions and, perhaps eventually control them. Where criminal proceeds are used to buy legitimate businesses, competitors find themselves unable to compete and are driven out of business. Unchecked, money laundering can destabilise financial institutions, sectors and, in certain cases, entire economies. Economic crime can damage financial markets and, thus, the reputation and health of a nation as a whole. It is the concern generated by these implications that have galvanised the international community into making concerted efforts to tackle money laundering.

3. These efforts are highlighted by the following initiatives:

* the 1988 UN Drugs Convention requires parties to criminalise drug money laundering;

* the Financial Action Task Force (FATF) set up in July 1989 by the G7 specifically to develop and promote policies to combat money laundering.

* the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime November 1990;

* the EC Money Laundering Directive of June 1991 requires Member States to prevent the use of their financial systems for money laundering;

* the Caribbean Financial Action Task Force (CFATF) the first regional body to follow the FATF.

4. The White Paper on Britain and the Overseas Territories (Partnership for Progress and Prosperity) noted that the Caribbean Overseas Territories are, in particular, a potential target for money launderers. The OTs should, therefore, have in place comprehensive measures to combat money laundering.

5. The White Paper checklist acknowledged, however, that this is an area in which the OTs have already made good progress. Most have now introduced "allcrimes money laundering legislation". This legislation must, however, be enforced and reviewed regularly. To their credit, all of the OTs are members of the Caribbean Financial Action Task Force and either have, or will shortly undergo, mutual evaluations.

6. The following guidance explains what HMG means by "comprehensive measures to combat money laundering".

INTERNATIONAL STANDARDS

The FATF 40 Recommendations:

7. The 40 Recommendations set the basic framework for anti-money laundering efforts and are designed to have universal application. The principles cover the criminal justice system, law enforcement, the financial system and its regulation and international co-operation. The essential components of the 40 Recommendations are as follows:

* Each country should implement a general framework which ratifies the Vienna Convention, and increases multilateral co-operation on money laundering cases.

* Each country should criminalise money laundering in relation to serious offences, not merely drug money laundering.

* Countries should also put in place measures to enable the tracing, freezing and seizing of criminal assets and the ultimate confiscation thereof.

* The following should be required of all financial institutions, whether they be bank or non-bank institutions:

customer identification "know your customer"

record keeping 5 years

special attention to complex/unusual/large transactions

immunity from prosecution if report suspicion in good faith

internal systems including training and designation of compliance officer

application of these requirements to foreign branches

* Each country should improve spontaneous or "upon request" international information exchange relating to suspicious transactions. This requirement is subject to strict safeguards necessary to ensure consistency with national and international provisions on privacy and data protection.

* Different definitions and standards between jurisdictions should not affect the ability or willingness of countries to provide each other with mutual legal assistance.

* There should be procedures regarding the use of compulsory measures including the production of records by financial institutions.

OTHER RELEVANT STANDARDS

CFATF additional 19 Recommendations:

8. In June 1990 representatives of Caribbean and Latin American States formulated a further 19 Recommendations specifically tailored to regional laws and circumstances. These acknowledged the need to devote adequate resources to this area, the need for competent authorities to specialise in it and that improvements would be ' required to legal systems to enhance the regulation and the role of the financial sector and to improve international co-operation. In particular the CFATF Recommendations urged members to:

* consider the practical evidentiary complications of limiting money laundering to only certain predicate crimes.

* criminalise conspiracy and/or aiding or abetting drug trafficking and money laundering offences.

* to consider making money laundering an offence both where the offender knew or ought to have known the origin of the funds.

* to make money laundering an offence no matter where the predicate offence took place.

* to acknowledge that the fact that a financial adviser is an attorney is insufficient reason to invoke attorneyclient privilege.

EU Money Laundering Directive:

9. Although this has no direct impact on the OTs, it is relevant in so far as it informs the UK law. The EU Money Laundering Directive of 10 June 1991 (91/308/EEC) requires Member States to prevent the use of their financial systems for money laundering. The EU suggests three main steps to combat money laundering: criminalise it; take measures to identify laundered proceeds with a view to confiscation; pass laws and establish systems to prevent the proceeds of crime being laundered in the first place.

10. The Directive also sets out requirements to be placed on the credit and financial institutions (as defined) of the Member States' jurisdictions. This includes customer identification and retention of records, relating to identification and transactions, for a period of five years. The Directive goes on to require Member States to place a requirement on such institutions to inform the authorities about suspected money laundering activity.

The UK law and practice:

11. The UK implemented the EU Directive by means of the Criminal Justice Act 1993, the Money Laundering Regulations 1993 and earlier legislation. The principal money laundering offences are set out in the Prevention of Terrorism (Temporary Provisions) Act 1989 and the Drug Trafficking Act 1994. The Criminal Justice Act 1988, as amended, contains the money laundering offences relating to the proceeds of crimes other than drug trafficking and terrorism. These are defined as all indictable offences, other than those covered by the 1989 and 1994 Acts, plus the summary offences set out in Schedule 4 to the 1988 Act. The latter include certain lucrative offences relating to sex establishments and the supply of unclassified videos.

12. The principal money laundering offences have a dual purpose. Firstly, to criminalise and so suppress money laundering activity. Secondly, to encourage the reporting of suspicious transactions to the authorities. In this second respect, the offences help to protect the integrity of financial institutions by deterring criminals from lodging proceeds in them, and also help to provide the police with new investigative leads.

Criminal Justice Act 1988, as amended by the Criminal Justice Act 1993:

13. The money laundering offences created by this legislation are as follows:

Assisting another to retain the proceeds of crime: to commit this offence, one must know or suspect that the person in question is or has been engaged in crime, or has benefited from it.

Acquiring, Possessing or using another's proceeds of crime: the offence only applies where the launderer acquires, possesses or uses the property for inadequate "consideration,' (payment). Thus, if one pays full value for the property one does not commit the offence. The provision of goods or services which are of assistance in criminal conduct is not regarded as "consideration".

Concealing another person's proceeds of crime: This includes concealing or disguising property; or converting or transferring property or removing it from the jurisdiction. Carrying out these activities must be for the purpose of assisting somebody to avoid prosecution for a relevant offence or the making of a confiscation order against him/her. Unlike the above offences, all that is required here is "reasonable grounds for suspicion". Thus the prosecution need only prove that the person laundering the proceeds **should have suspected.**

Laundering one's own proceeds: This includes the same activities as concealing another person's proceeds and one must conceal, disguise, convert, transfer or remove property from the jurisdiction for the purpose of avoiding one's own prosecution for a relevant offence or the making of a confiscation order against oneself.

14. The penalties for all of the above offences are fourteen years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction (currently £5,000).

15. The legislation also includes the following offences:

Tippingoff offences: These apply when a money laundering investigation is being, or is about to be, conducted, and where a suspicious transaction report has been made, or a suspicion of money laundering has been disclosed to the authorities. The offence can be committed where one knows or suspects that an investigation is being conducted, or is about to be, or a disclosure has been made.

16. The penalties for tippingoff are five years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction.

The Money Laundering Regulations 1993:

17. Another essential part of the UK's antimoney laundering defences are the Money Laundering Regulations. They require financial institutions to put in place systems to deter money laundering and to assist the authorities to detect money laundering activities. The Regulations apply to:

* all banks, building societies and other credit institutions,

* all individuals and firms authorised to conduct investment business under the Financial Services Act 1986,

* all insurance companies covered by the EC Life Directives, including the life business of Lloyds of London,

* all other undertakings carrying out any of the range of financial activities listed in the annex to the Second Banking Directive (89/646/EEC, SI 1992,3218). This includes bureaux de change and money transmission services.

18. The Regulations establish criminal offences for those who fail to ensure adequate systems are in place and maintained. Thus, the Regulations require:

* procedures to ensure identification of customers, maintenance of records relating to identification and transactions, or such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering;

* appropriate measures to be taken from time to time to make employees who handle relevant financial business aware of the procedures and the money laundering statutes;

* provision of training for those employees from time to time in the recognition and handling of transactions which may be money laundering.

19. Where an offence is committed by a body corporate, partnership or unincorporated association, the directors and managers and certain other people may be guilty of the offence as well. Penalties for contravention of the Regulations are two years imprisonment and an unlimited fine on indictment and a fine not exceeding the statutory maximum on summary conviction.

Money Laundering Guidance Notes:

20. In addition to the above, the British Bankers Association have produced guidance notes for the industry in association with the Building Societies Association and the law enforcement authorities. Similar guidance notes have also been produced for the insurance and investment business sectors.

COMPLIANCE WITH THESE STANDARDS

21. With regard to the OTs, we have encouraged the OTs to put in place measures equivalent to those in the UK. Most have now implemented the primary legislation. However, work on the essential supporting measures still needs to be completed.

Regulations:

22. Many OTs have opted to implement voluntary codes of practice rather than an equivalent to the UK Money Laundering Regulations 1993 (the Regulations). **To be effective these need to be placed on a statutory footing** providing for criminal offences in the event that monitoring and reporting systems are not created and maintained.

23. Effective operation of the antimoney laundering legislation relies on the vigilance of financial institutions and the reporting of suspicious transactions. While the requirement to put in place monitoring and reporting systems is voluntary, the risk of commercial interest frustrating the intent is concrete. Placing these requirements on a mandatory footing would enable the OTs to ensure that the supporting mechanisms for their money laundering defences could be enforced. It would also send a clear signal to the financial sector that "all money is not simply money", and that certain types of financial activity were unacceptable.

Resources and enforcement:

24. It is clear from the above that the creation of anti-money laundering defences requires considerable input of resources on the part of the financial institutions. This, however, is only one part of the equation. There is little point in requiring the financial sector to report suspicious transactions if there is an inadequate ability on the part of law enforcement to respond.

This means that OT Governments must devote considerable resources to ensuring that the law enforcement capacity for analysing suspicious transaction reports and, where appropriate, acting on them is sufficient. This will apply not only to reports submitted by institutions operating within the jurisdiction, but also to requests for assistance on money laundering investigations from foreign jurisdictions. It is, therefore, essential that the Financial Investigation and Intelligence Units in the OTs are adequately staffed with trained personnel capable of conducting financial investigations and analysis.

25. In addition, it will also be necessary to ensure that the Attorney Generals' Chambers and the judiciary in each OT are appropriately resourced and trained to handle the types of cases which may result from enforcement of the money laundering laws. Again, this relates not merely to prosecutions of offences within the OTs, but also to provision of assistance to foreign jurisdictions in pursuance of the antimoney laundering legislation. Where appropriate, HMG is willing to provide assistance on a short term basis. However, it will be for the OTs to ensure that they budget appropriately for these responsibilities in the future.

International co-operation and confiscation:

26. It goes without saying that a great deal of money laundering involves transactions spanning a number of jurisdictions. The more complex the transactions and the more jurisdictions involved, the harder it is for law enforcement to follow the money trail. The abolition of exchange controls in the late seventies and early eighties, and the rapid improvement in technology means that it is possible instantly to transfer money of any amount or denomination virtually anywhere in the world. Much criminal law is territorially based, and differs from jurisdiction to jurisdiction, so the investigation and prosecution of financial crime and money laundering are very dependent upon mutual legal assistance between states.

27. The confiscation and money laundering legislation which the OTs have been enacting enables many of them to co-operate in international asset tracing investigations, and in the restraint and confiscation of the proceeds of drug trafficking and other crime. Given the percentage of financial business in the OTs which has its origins in other jurisdictions, it is vital that these provisions for international cooperation are fully implemented and, when implemented, operate effectively. At a time when much attention is being focused internationally on offshore centres, it is in the OTs interests to ensure their reputation for being willing and able to assist in tracing, freezing and confiscating criminal proceeds is second to none.

28. HMG is mindful of OT concerns that they may invest considerable resources in providing investigative assistance in proceeds of crime cases, only for the assets to be confiscated elsewhere and retained by the confiscating jurisdiction. In our view, international asset sharing from which some OTs have benefited considerably in recent years provides the best way to ensure that the costs of international casework is shared equitably among cooperating jurisdictions. we strongly support the sharing of confiscated assets relating to all crimes, including drug trafficking, and are working internationally to promote progress in this area. We are happy to discuss continuing concerns about costs with the OTs, and have asked them whether they would be interested in having the Council of Europe Convention extended to their jurisdictions.

Fiscal offences:

29. International standards indicate that money laundering should be criminalised in relation to all serious crime, not merely drug trafficking. The principles leave the definition of serious crime to the individual jurisdictions. At the same time, however, **they also make it clear that such individual definitions should not affect the ability "or willingness" of countries to provide mutual legal assistance.**

30. In the UK we treat tax evasion as a serious crime so it is caught by our confiscation and money laundering legislation. We are aware that different jurisdictions treat specific tax offences in different ways. Experience suggests that this can create problems where money laundering investigations relate in some way to tax offences.

31. The "tax issue" can arise in two ways. First, the predicate offence to which the money laundering offence relates is a tax offence. Assume the predicate offence takes place in jurisdiction A and the money laundering offence takes place in jurisdiction B. A problem is created where the latter does not recognise the tax offence in question as a predicate offence to which its money laundering legislation applies. As a result it will not provide co-operation to jurisdiction A in its investigations. Second, the predicate offence may be another serious crime, such as drug trafficking. It is, however, disguised as a tax related problem to ease the process of laundering. Nonrecognition of tax offences, or non-cooperation on money laundering cases involving such offences can frustrate all sorts of criminal investigations. In either of these scenarios, the inability to cooperate where tax is, or appears to be, involved creates a loophole in the anti-money laundering defences which criminals will utilise.

32. Failure to provide adequate coverage for this issue in the antimoney laundering defences has two serious drawbacks. it makes it easier for criminals to get away with tax evasion, which we regard as a serious crime, and it undermines efforts to

combat other forms of offending.

33. There is some concern that the inclusion of tax offences as predicate offences, for the purposes of the money laundering legislation, will place a requirement on financial institutions to know and understand the fiscal regimes in other jurisdictions. This is quite wrong. Under the money laundering offences one is only required to consider whether one has a suspicion of something which would be a crime in one's own jurisdiction. it is also argued that it is difficult or impossible to determine whether a transaction is indeed linked to drug trafficking, tax or any other specific crime. However, the financial institutions and their employees are not expected to investigate suspicions, but to disclose them. As noted above, in the case of the UK, this includes disclosing suspicions of tax evasion. It is worth noting, however, that cooperation on money laundering investigations involving tax offences does not necessarily require such offences to be made predicate. There may be other related offences which fall within the ambit of a jurisdiction's money laundering legislation.

34. There is also an argument that "there is no such thing as the laundering of money from tax fraud', on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime.

35. The UK's confiscation, money laundering and judicial co-operation legislation enables us to trace, freeze and confiscate the proceeds of tax evasion, or any other crime, on behalf of other jurisdictions. Where restraint and confiscation are concerned, the conduct overseas must correspond to an applicable offence in the UK. **However, much investigative assistance can be provided without any dual criminality requirement.** We can, and do, assist in foreign tax evasion cases, including cases where the conduct is not necessarily an offence in the UK.

36. As part of the efforts to combat money laundering, the UK is encouraging others to close loopholes. We would, therefore, encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able.

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3 (Copies of Guidance Notes to be provided to Consultants.) Back

4 Clive Briault: *The Rationale for a Single National Financial Services Regulator* - May 1999 Back

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We welcome your comments on this site.

Prepared 27 October 2000

Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda — The Turks and Caicos Islands

1 Executive Summary

1.1 Introduction

This is one of six reports we have issued covering the Caribbean Overseas Territories and Bermuda. This report deals with the Turks and Caicos Islands ("TCI").

The Turks and Caicos Islands form the south-eastern extremity of the Bahamas chain. They lie 145 km north of Haiti and the Dominican Republic and 925 km south-east of Miami. The territory comprises some 40 islands with a total land area of 500 square km. The estimated population of TCI is 20,000.

Constitutionally, TCI is an internally self-governing Overseas Territory with a ministerial system of government. Government is run through a Governor appointed by the Crown, and Executive and Legislative Councils. The Governor retains responsibility for internal security, external affairs, defence, the public service and (importantly, in the context of this review) offshore finance. Parliamentary elections are held at intervals of not more than four years.

The TCI's GDP per capita in 1998 was estimated to be US$ 6,000 with an estimated growth rate of 5%. Tourism and offshore finance are, in that order, the two main pillars of the economy.

The 1999 White Paper explains that, like other territories, TCI faces a serious threat from drug trafficking and related money laundering. A national drugs co-ordinator has been appointed and a national drugs committee co-ordinates national efforts in dealing with trafficking and money laundering.

1.2 Financial services in TCI

TCI is a significant centre for offshore services, particularly in relation to insurance and trusts. It also has a strong company incorporation sector. Other financial services activities, whilst taking place, do not constitute a major part of TCI's business in this sector.

As at 31 December 1999, there were 2,512 licensed insurance companies, of which 2,322 were specialist "credit life" Producer Owned Reinsurance Companies ("PORCs"). No statistics in relation to premiums, assets or liabilities are available as these companies do not file accounts.

Also as at 31 December 1999, there were 13,499 exempt companies (which conduct business outside TCI) and 2,545 ordinary Companies Act companies (primarily conducting local business). There are also 114 companies registered under the Limited Life Company Act.

There are currently 35 companies based in the jurisdiction which act as company service providers. The majority of this work is carried out by local lawyers and accountants, although there are also several local company managers.

As at the end of March 2000, there were eight banks licensed by the local Financial Services Commission ("FSC"), holding total deposits of US$539 million and total assets of US$618 million. The FSC is the home supervisor of three banks, which have no foreign branches or subsidiary operations.

In respect of the securities/investment business, we have been informed by the FSC that only three companies are carrying out this business in the jurisdiction. Of these, two are local companies which are affiliated to trust service providers and the other is a locally incorporated subsidiary of an international broking firm.

The number of mutual funds either incorporated or otherwise operating in the jurisdiction was approximately ten as at 14 March 2000, according to statistics supplied by the FSC. This data is an estimate.

As at 31 May 2000 there were 57 limited partnerships registered in TCI.

As in most other jurisdictions, there is no requirement to register trusts in TCI. The FSC has told us that over 1,000 trusts are believed to be being administered locally, holding assets of over US$500 million.

1.3 **Financial services regulation**

As referred to above, under the constitution the Governor has ultimate regulatory responsibility for offshore banking and financial services.

Day-to-day regulation is the responsibility of the FSC. It currently employs twelve people (including six in the companies registry) and has identified three further vacant posts, funding for two of which has been approved. These posts are for a finance officer, an analyst and an insurance officer. The FSC is a government department and is part of the Ministry of Finance.

There is legislation in place covering the regulation of banking (both domestic and offshore), insurance (both domestic and offshore), mutual funds, professional trustees and company service providers. The legislation relating to mutual funds is not yet in force, nor is the latest legislation relating to company service provision.

There is no specific regulatory legislation relating to securities/investment.

1.4 **Summary findings on the areas under review**

1.4.1 **Introduction**

The following matters represent a summary of our findings, and represent only the key issues arising from our review. As such they should be read in conjunction with the report as a whole.

1.4.2 **Structure of the regulatory authority**

In our view the FSC has made steady progress in developing its regulatory capability and has some experienced senior staff. However, we do not consider the current regulatory structure to be fully in accordance with international standards in two important respects.

First, the Governor is ultimately responsible (through the Regulator) for licensing and enforcement action relating to financial service activity. The Regulator reports to the Permanent Secretary, Finance (a TCI official) on staffing, budgeting and operational matters. This means that the regulator is not operationally independent. We recommend that the FSC should become an independent regulatory body and that the current powers exercised by the Governor, the Permanent Secretary and those held by the individual regulators are transferred to the new body.

Secondly, there should be an increase in staffing resources to enable the Regulator to meet its obligations. We understand that further recruitment is in progress; however, we consider that staff additional to this should be recruited to meet the extra workload that will be involved for on-site supervision and strengthened regulation of the insurance sector in particular.

1.4.3 **Banking**

TCI is in the process of developing its regulatory approach to banking. We consider the efforts being made as a positive feature of TCI's regulatory environment. The FSC fully accepts that, whilst some Basel Principles are being complied with, further work is necessary in order to create a regulatory regime that is fully in compliance with international standards.

The main areas for development include:

- the establishment of an on-site supervisory programme;
- the enhancement of off-site supervision; and
- the provision of greater enforcement powers for the regulator.

We also consider that the legislation is not sufficiently clear in a number of areas, including regulatory access to the records of individual depositors and the notification/approval of changes to beneficial ownership. We therefore recommend that the law is changed to clarify the position.

1.4.4 **Insurance**

The insurance industry in TCI has been built upon the growth of credit life insurance/ PORC business, which the jurisdiction believes is instrumental in developing the financial services industry.

Regulation of PORCs in TCI is not currently in accordance with developing good practice or international standards, and reform is, therefore, required in this sector. Whilst there are regulations relating to PORCs in force (for example, initial vetting checks are carried out), exemptions in the Insurance Ordinance mean that in practice there is largely a regime of self-certification. We agree with the Superintendent of Insurance that in line with developing international standards, this approach to regulation needs to be re-examined.

Because the capacity exists in TCI to vary standards of insurance supervision in respect of PORCs through an exemptions process, it is difficult to assess the degree to which compliance with IAIS Principles is achieved. In our view the flexibility possible in regulation does not accord with good practice.

Ultimately we consider that consistent standards of regulation should be applied to all types of insurance business.

We also consider that regular periodic on-site supervision of domestic TCI insurance companies should be commenced. However, as an initial measure, key information relating to matters such as underwriting and reserve policy should be obtained from licence holders. Furthermore, as considerable reliance is placed on the work of third parties for these companies, we recommend that periodic information from these parties is received on a timely basis.

1.4.5 **Securities/investments**

Whilst we have been advised that there is only a limited amount of securities/investment business currently being undertaken in TCI, this may well increase as TCI continues to develop its financial services activities.

It is the FSC's belief that since such activity is limited it can, at least to a certain extent, be controlled by the requirement that anyone wishing to engage in investment or securities business must hold a business licence (under section 3 of the Business Licensing Ordinance). However, the FSC has advised us that this Ordinance covers persons wishing to engage in business generally and is a licensing rather than regulatory regime which does not focus on the conduct of the licensed business.

The absence of an adequate legislative and regulatory framework for securities and investment business means that TCI is not in compliance with international regulatory standards as set out by IOSCO. We consider that this deficiency needs to be addressed.

1.4.6 **Mutual funds**

The enactment of legislation relating to the regulation and supervision of mutual funds in TCI is a positive step. However, legislation is not yet in force and therefore, TCI is not in compliance with the applicable IOSCO principles. This legislation should be brought into force as soon as possible.

We also recommend that the draft underlying regulations are finalised in line with international standards.

1.4.7 **Companies**

We have not undertaken a thorough review of the Companies Ordinance ("CO") as this is beyond our Terms of Reference ("TOR"). Our specific recommendations should be considered in that context. We have, however, reviewed those aspects of the legislation that bear directly on our TOR and have taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

From our review it is apparent that the CO is a comprehensive piece of legislation containing many of the features that we would expect to find. We are of the opinion that the CO complies with some, but not all, of the good practice standards set out in the Guidance Notes. However, given the scope of the TOR, there are a number of areas that we have not reviewed. We consider that the legislation should be subjected to a more detailed review which should include the insolvency provisions.

It is principally in respect of exempted companies that we consider that the CO fails to comply with good practice standards.

We have also made a number of other recommendations designed to reduce the potential for companies to be used for money laundering, fraud or other illegal purposes. The principal recommendations relating to this are:

- the "immobilisation" of bearer shares;
- the introduction of a capability in the CO to disqualify a person from acting as director of a TCI company;
- that the names of directors should form part of the publicly available information held at the companies registry; and

- that the enforcement powers under the Companies Ordinance be increased to include the express ability to initiate an investigation into a company on public interest grounds, the results of which would be passed to other regulators through gateways.

The issue of bearer shares is particularly important. Measures should be introduced whereby:

- the regulator can, where necessary, find out the ownership (through the licence holder);
- there are adequate legal powers to require this information to be kept and disclosed; and
- in appropriate cases it can then be passed, as indeed can other company information not concerned with bearer shares, to regulators in other jurisdictions, through "gateways".

1.4.8 **Company service providers**

TCI has recently enacted legislation, the "Company Management (Licensing) Ordinance" ("CMLO") for the regulation of company service providers. However, this also has not yet been brought into force. We are advised that it will come into force in November 2000. This current failure to bring the regulatory regime into effect is therefore a concern and means that TCI are not as yet in compliance with good practice.

Furthermore, we consider that the new regulatory regime requires some enhancements. The principal areas for improvement are:

- the need to provide for powers to enable the Superintendent to gain access to client information;
- the provision of greater enforcement powers for the regulator;
- the need for an effective on-site and off-site regulatory regime to be initiated; and
- the introduction of an enforceable regulatory code or regulations covering the way in which a corporate service provider undertakes its duties.

1.4.9 **Partnerships**

We are of the view that in some respects TCI meets good practice standards but that it does not meet all of them.

In particular, we recommend that those who, by way of business, form limited partnerships or provide registered offices for limited partnerships should be licensed and subject to regulation.

A limited partnership should be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership. The registered office should maintain in writing details of the location of these records.

We also recommend that the Registrar of Companies (who is also responsible for the registration of limited partnerships) should have enforcement powers to:

- apply to the courts for the dissolution of a partnership on public interest grounds or on grounds of fraud or insolvency; and
- apply to the courts for the appointment of an inspector to investigate the activities of a limited partnership.

1.4.10 **Trusts**

Trust legislation in TCI is similar to the trust legislation in a number of other jurisdictions.

We consider that, if there is to be no "motive test" under the Voluntary Disposition Ordinance, there should be a reasonable period of time for any creditors to challenge the validity of the trust.

As a further general point, rather than one specific to TCI, we recommend that legislation is amended to prevent the use of so-called "flee" clauses in trust documents to frustrate legitimate creditors or to prevent regulatory or criminal investigation.

1.4.11 **Trust service providers ("TSPs")**

The TCI substantially meet the requirements of TSPs as set out in the Guidance Notes. There are, however, some improvements which need to be achieved to bring regulation of TSPs fully in line with the Guidance Notes.

We recommend, *inter alia*, minor enhancements to the Trustees Licensing Ordinance ("TCO") and the extension of its scope to include individuals and partnerships who provide trust services. Furthermore, the Superintendent of Insurance should be granted access to client files in order to effectively conduct on-site supervision.

1.4.12 **International co-operation**

TCI has a number of Ordinances which provide for the confidentiality of information and for co-operation between regulatory authorities and between law enforcement authorities. However, we consider that the significant number of different legislative provisions make the position unnecessarily complex.

We recommend, therefore, that TCI Government considers enacting consolidating legislation, particularly with regard to co-operation, which would make it much easier for foreign regulatory and law enforcement agencies to ascertain what routes can be used.

The legislation taken as a whole meets many of the international and good practice standards in the Guidance Notes. However, we consider that some enhancements are necessary and that TCI will need to enact legislation providing equivalence to the Model Compulsory Powers Ordinance.

We note, in particular that, with the exception of the MFO, there are gateways through which the various Superintendents can pass information to foreign regulatory authorities, but that these do not extend to client information. We therefore consider that they do not fully comply with international standards.

We are also concerned that there are not sufficient powers to enable the provision of information to a foreign law enforcement authority at the investigation stage in a non-drugs matter, when the Evidence (Proceedings in Other Jurisdictions) (Turks and Caicos Islands) Order ("EPOJO") will not apply.

1.4.13 **Anti-money laundering**

The TCI has recently introduced a number of legislative provisions designed to bring it into compliance with international standards, including modern all crimes anti-money laundering legislation. The legislation, taken as a whole, is reasonably extensive and contains much of the material and covers most of the issues that we would expect to find in the legislation of a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of TCI's commitment to prevent money laundering.

However, some enhancements are required to the legislation. Furthermore, as the legislation, framework and systems are very new, we have not been able to undertake an effective review of how they are working in practice and we are therefore unable to make many recommendations. The FSC will need actively to monitor compliance. We consider that the most important areas for the FSC to monitor will be trust and company administration. It would be worthwhile for a further review of the systems and procedures to be undertaken once some empirical evidence is available.

Additionally, the recommendations contained in the other sections of this report relating to changes in the regulatory structure and international co-operation should be implemented, particularly those concerning regulatory on-site visits, which should cover compliance with the money laundering regulations.

We consider that the fact that no suspicious transaction reports have been made under the CDTO may be indicative of a lack of understanding of the legislation by the private sector. The introduction of the PCMLR must therefore be accompanied by a formal training workshop(s) for the private sector advising them of their responsibilities under the legislation and regulations.

1.5 **Conclusion**

Much progress has been made in enhancing the regulatory framework, with a considerable volume of new legislation passed. This is to be welcomed, although parts of it (e.g. that dealing with mutual funds and company service providers) have yet to be brought into force and several amendments and additions are needed such as the ability for the Superintendent to access client files.

There remain areas where financial regulation still falls short of good practice and international standards, and where progress is needed. This is particularly important given the threat to TCI from potential fraud and (as referred to in the White

Paper) from drugs-related money laundering, but also applies to other fields such as the regulation of insurance companies.

Considerable further progress is required on international co-operation in the field of gateways and the provision of assistance to foreign law enforcement authorities at the investigative stage (except in drugs-related matters, where the powers are now available).

In our view, stronger support should be given to the FSC in terms of budgets, staffing, independence and legislation to enable it to continue to move forward and improve regulation.

We welcome your comments on this site.

Prepared 27 October 2000

2 Methodology

2.1 Introduction

2.1.1 The UK Government White Paper

The UK Government White Paper "Partnership for Progress and Prosperity: Britain and the Overseas Territories" ("the White Paper")[1] was presented to the UK Parliament in March 1999.

The White Paper recognised that the international financial service industry has grown dramatically in recent decades and that a significant number of the Overseas Territories have developed successful offshore financial sectors and so diversified their economies. The White Paper further commented that it was essential for the future of the financial services sector that the Overseas Territories reputation for honest administration and probity be preserved and enhanced.

The White Paper stated that development of sizeable financial sectors brings risk of abuse and that as markets develop and techniques for laundering money, fraud, tax evasion and regulatory abuse evolve so financial regulatory systems must improve, be updated and be responsive to ever tighter international standards.

The White Paper further stated that the Caribbean Overseas Territories in particular are a potential target for money launderers because of their offshore financial business, their proximity to major drug producing and consuming countries and, in some cases, their inadequate standard of regulation and strict confidentiality rules. The White Paper also stated that the Territories are also at risk from attempted fraud and that failure to tighten regulation could affect the stability of and confidence in financial markets. The White Paper emphasised the importance of the Overseas Territories meeting accepted international standards. To assess progress made in this area, it required an in-depth independent review to be undertaken by regulatory experts. This review was also to make recommendations as to how to deal with any issues outstanding.

2.1.2 Development of the review process

Following the publication of the White Paper, a Steering Committee was formed. This Committee comprised representatives of the Foreign and Commonwealth Office ("FCO"), the Treasury, the Financial Services Authority and the Governments of the Overseas Territories.

The Steering Committee approved the Terms of Reference ("TOR") for this review, together with Guidance Notes on international standards and good practice relating to the areas under review. We understand that the guidance on accepted international standards in financial regulation ("the Guidance Notes") contained within the TOR was arrived at following a process of detailed consultation and discussion between representatives of the Overseas Territories, the FCO, HM Treasury and the UK Financial Services Authority. These are attached in Appendix 1.

The Guidance Notes represent good practice. The Overseas Territories have therefore chosen to be assessed against standards which, in a number of areas (such as company and trust service provision), are not applied in a number of major centres. This approach demonstrates the commitment of the Overseas Territories in seeking to ensure that financial regulation in these jurisdictions will eventually meet high standards. As such they are providing a powerful role model to other offshore centres.

The Guidance Notes do not prescribe how particular standards should be achieved; rather, the Overseas Territories are left to decide for themselves how best to achieve the standards laid down in them.

On 20 December 1999 we were appointed by the FCO, acting on behalf of the Steering Committee, to undertake the review of financial regulation referred to above.

The review covers Anguilla, Bermuda, the British Virgin Islands ("BVI"), the Cayman Islands, Montserrat and the Turks & Caicos Islands ("TCI") (referred to collectively as the Overseas Territories). The White Paper covers a wider number of locations (such as Gibraltar) but this review is restricted to these six Overseas Territories.

The purpose of the review has been to assess the Overseas Territories' performance against international standards and good practice, and to make recommendations for improvement where any territory falls below those standards.

2.2 **Scope of the review**

The scope of the review was as follows:

In relation to the regulation of financial services activity

- List separately the type and composition of offshore financial services business in each Overseas Territory.
- Ascertain what legislation, regulations, rules, guidance, systems and procedures (statutory or otherwise) govern the regulation and supervision of the:

  - Banking sector

  - Insurance sector

  - Securities sector (including mutual funds and stock exchanges).
- Assess the monitoring, supervision and regulation of activity as well as the enforcement of rules, regulations and laws.
- Evaluate to what extent arrangements in the Overseas Territories meet the standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).
- Consider the adequacy of the system of supervision relative to the objectives of Overseas Territories' financial services regulation.
- Comment on the existence and adequacy of depositor and investor protection schemes.
- Determine whether further action is required by any territory in order to meet the standards set out in the Guidance Notes and prioritise recommendations.

In relation to the regulation of companies, partnerships and trusts

- Ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts.
- Detail the type of information available on the activities of companies, partnerships and trusts.
- Determine whether the regulatory mechanisms in place are sufficient to meet international standards.
- Consider whether further action is required by any Overseas Territory to meet the standards required and prioritise recommendations.

In respect of independent regulatory authorities

- Evaluate to what extent regulatory authorities comply with accepted international standards advocated principally by Basel, IOSCO, the Offshore Group of Banking Supervisors (OGBS) and IAIS.
- In particular, evaluate whether regulatory authorities are accountable, independent and free from business and political influence and properly staffed and budgeted for with an independent source of income.
- Determine whether the relevant authority is detached from the marketing of financial services and, where this is not so, assess any impact this may have on the ability of the regulatory authority to regulate the sector objectively.
- Assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; co-operate with requests for assistance from foreign authorities; enforce rules, regulations and laws by taking enforcement action; and the extent to which they can liaise with law enforcement authorities in the sharing of information.
- Consider which activities fall under the responsibility of the regulatory authority and whether the regulatory net

covers all financial activities.

- Consider what legal advice is available to the authority and its effectiveness in helping the Overseas Territory's government to regulate the sectors.

In relation to international co-operation

- Evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of the Overseas Territory's law enforcement and regulatory authorities to co-operate with requests for assistance from foreign authorities.
- Ascertain what legal advice is available to regulatory and law enforcement authorities in the Overseas Territory, and determine effectiveness in helping the Overseas Territory's government to co-operate in these areas.
- Determine whether further action is required by any territory in any of these areas, and the relative priority of such action.
- Consider whether there are effective "gateways" provisions in place concerning co-operation between regulatory authorities as well as the Overseas Territory's powers to obtain information, including by compulsion, the ability of foreign authorities to take voluntary testimony from the Overseas Territory's residents and the Overseas Territory's ability to safeguard the confidentiality of information provided by foreign counterparts. In addition, determine whether there are any provisions governing conditions under which information may be passed to overseas jurisdictions and whether effective memoranda of understanding exist (where required to underpin co-operation).
- Assess the extent to which the Overseas Territory's law enforcement authorities can obtain evidence on behalf of their foreign counterparts and exercise other available mutual legal assistance powers, stating the mechanisms and the Overseas Territory's authorities involved.
- Assess the Overseas Territory's ability to assist foreign authorities in tracing, freezing and confiscating proceeds even if the underlying conduct takes place outside the Overseas Territory.
- Assess the effectiveness of mutual legal assistance treaties with the USA where applicable and provide the basic volume of requests for assistance made and received.
- Assess powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted.
- Assess the ability to safeguard the confidentiality of information provided to Overseas Territory's law enforcement authorities.
- Assess whether effective memoranda of understanding exist, where required, to underpin co-operation.
- Evaluate whether there is effective co-operation between law enforcement authorities and financial regulators both domestically and abroad.
- Consider the ability of the Overseas Territories' regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

In relation to measures to combat money laundering

- Establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the Overseas Territories to combat money laundering and types of offences caught by the legislation.
- Determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.
- Evaluate the effectiveness and adequacy of those arrangements in terms of how they meet the applicable international standards.
- Provide specific consideration to the offences considered predicate for the purposes of money laundering legislation.

- Consider whether the Overseas Territories' have regulatory legislation in addition to the principal money laundering offences and, if not, whether guidelines and/or codes of practice exist (statutory or otherwise).
- Consider the Overseas Territories' systems for reporting suspicious transactions and identifying customers, the institutions obliged to report, how reports are dealt with and within what timeframe.
- Consider how this information is disseminated and shared with foreign counterparts.
- Evaluate the ability of financial intelligence units or their equivalent to deal with suspicious transactions.
- Determine to what extent the Attorney-General's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws.

2.3 **Project governance**

2.3.1 **The Steering Committee**

The Steering Committee played a key role in setting the parameters for and guiding the conduct of the review by its involvement in:

- agreeing the TOR and benchmark standards to be applied by the review team prior to its appointment;
- offering guidance over the detailed review process through a series of Steering Committee meetings which took place at key stages in the review process; and
- agreeing the format and reviewing the content of this report and providing comment as appropriate.

The responsibility for the opinions expressed, is however, a matter for KPMG.

2.3.2 **The Strategic Team**

In undertaking the review, KPMG utilised a Strategic Team composed of former senior regulators from a number of different jurisdictions, as well as its own partners and staff. The involvement of these individuals enabled the assessment better to take into account how the standards are implemented in practice on an international basis.

Members of the Strategic Team have had significant involvement in the setting of international standards as well as their implementation. The team included a former Chairman of IOSCO's Technical Committee, the Director of Regulation at Lloyd's of London, a former Deputy Director of the United States Securities and Exchange Commission of International Affairs, a former executive Director of the Hong Kong Securities and Futures Commission and the former Chief Executive of the Isle of Man Financial Supervision Commission.

The external members of the Strategic Team provided advice and guidance to KPMG, particularly during the early stages of the project and through the initial drafting of this report. The role of the external members of the Strategic Team was advisory, however, and the analysis and recommendations in this report are the responsibility of KPMG.

2.3.3 **Responsibility for this report**

This report has been prepared by the UK firm of KPMG. Although we have associated firms in the Overseas Territories, they have not been involved in the preparation of this report, nor should any responsibility for any of the opinions in this report be attributed to them.

2.4 **Approach to the review**

2.4.1 **Structure of the report**

The individual sections of the report are generally divided into a number of parts, as follows:

- an introduction, giving a broad outline of the international standards and/or good practice against which our assessment is made;
- a description of the nature and scale of the activity in the jurisdiction;

- a factual assessment produced in conjunction with the Overseas Territory which has been formally confirmed by them as accurate; and
- a section covering the issues arising from our analysis, together with recommendations we consider appropriate to remedy any deficiencies identified.

2.4.2 **Benchmarks**

In determining the appropriate international standards and good practice we have, as instructed in the TOR, used the Guidance Notes.

In the areas of banking, insurance, securities/investments and stock exchanges there are established international standards by which compliance can be assessed. Similarly, with respect to anti-money laundering measures, the recommendations of the Financial Action Task Force and the Caribbean Financial Action Task Force provide benchmarks.

However, in other areas, such as the provision of company and trust services, there are no internationally accepted standards. The Guidance Notes have instead been based upon what has been agreed as good practice.

In accordance with the TOR we have, in conducting this review, taken due notice of the recommendations made in the recent Home Office report on the Review of Financial Regulations in the Crown Dependencies. However, the terms of reference for the two reviews are substantially different in that benchmark standards were not defined in the Home Office review and hence there was no requirement to make an assessment against them.

Accordingly, in framing our recommendations we have assessed compliance with the benchmark standards set out in the TOR.

2.4.3 **Phases of the review**

2.4.3.1 ***Legislative review***

At the outset of the review the Overseas Territories provided us with copies of relevant legislation and regulations.

2.4.3.2 ***Pre-visit questionnaires***

Prior to commencing our on-site reviews, we prepared a pre-visit questionnaire for completion by each of the Overseas Territories. The questionnaire covered the areas required by the TOR. A draft questionnaire was reviewed by the Steering Committee and their comments were incorporated prior to issue. Comments were also invited and received from other parties with experience in relevant areas, for example the FATF in respect of money laundering.

Following this consultation the questionnaire was issued and responses received from the Overseas Territories. These responses were analysed by us prior to the commencement of the on-site review.

2.4.3.3 ***On-site review programme***

The analysis of questionnaire responses was used to prepare a work programme for the on-site review. This mechanism was important in ensuring that the on-site stage of the work was completed to a consistent standard across all the Overseas Territories.

2.4.3.4 ***On-site review***

The on-site review was undertaken in March and April 2000. It comprised in excess of twenty-six man weeks in the Overseas Territories. A total of eight staff, together with two members of the Strategic Team, were deployed across the Overseas Territories. Each consultant was allocated a specific area for review in line with their sector specialism. Work was conducted in line with the on-site review programmes outlined above, adjusted where necessary for issues identified on-site.

2.4.3.5 ***Meetings with third parties***

As part of the review process we had extensive discussions and meetings with third parties (in the UK, the Overseas Territories and elsewhere) who had experience of, or an interest in, the jurisdictions under review. These third party discussions were particularly pertinent in the areas of international co-operation and anti-money laundering measures.

Meetings with the third parties referred to above included:

- The United States Securities and Exchange Commission ("SEC");
- The United States Department of Justice ("DoJ");
- Representatives of the Overseas Territories;
- The United States Federal Reserve;
- The White Collar Criminal Investigation Team ("WCCIT");
- The Overseas Territories Regional Criminal Intelligence System ("OTRCIS");
- The Financial Services Authority ("FSA");
- The National Criminal Intelligence Service ("NCIS"); and
- The Ontario Securities Commission ("OSC").

2.4.3.6 ***Findings from previous reviews***

Our review also considered the results of previous reviews of sectors of the various Overseas Territories. These included:

- the 1992/3 Bank of England "Report on the arrangements for the supervision of offshore banks", covering Anguilla, the BVI, Montserrat and the TCI;
- the CFATF mutual evaluation of Bermuda, the BVI, the Cayman Islands and the TCI; and
- the 1993 Sullivan Reports on the regulation of insurance in Anguilla, the BVI, the Cayman Islands, Montserrat and the TCI.

In addition to the above, we have used other information sources including promotional and advisory material issued by the Overseas Territories and others.

2.4.3.7 ***Reporting***

Whilst we have sought to give due credit for regulatory achievement wherever possible, it should be noted that our reports are phrased on an exceptions basis. We have identified issues and made recommendations in those areas where we consider they are required. The nature of our issues and recommendations tend to reflect the stage of regulatory development reached by the jurisdiction in question.

Those jurisdictions with more mature financial sectors and better developed regulation have tended to generate more detailed recommendations.

In those jurisdictions where we have identified a more significant lack of basic regulatory structures, our recommendations are, necessarily, focused on the major issues to be addressed. There will inevitably be many subsidiary issues which will need to be considered following action on those which are more fundamental. It is impossible to anticipate these until those more significant issues have been addressed.

2.4.3.8 ***Confirmation of factual accuracy and discussion of findings***

Following the on-site reviews, we issued initial draft reports in May 2000. We then visited each of the Overseas Territories over a two-week period at the end of May.

This second visit was designed to give the Overseas Territories the opportunity to comment on findings and confirm the factual accuracy of the initial draft reports. Comments received during the course of this visit were confirmed (where they related to issues of factual accuracy) and considered. Our draft reports were adjusted where the review team considered this to be appropriate.

Following these second on-site visits, further draft reports were prepared. These were issued on 17 July. They were also discussed with the Overseas Territories who (along with the Steering Committee) were again given an opportunity to comment. Written as well as oral comments were received from the Overseas Territories and others; all have been carefully considered.

The Overseas Territories have provided formal written confirmation of the factual accuracy of the relevant parts of our reports.

2.4.4 **Regulatory arbitrage**

Regulatory arbitrage is the selection of a jurisdiction of operation on the basis of the regulatory legislation and structure in place. Regulatory arbitrage tends to result in persons who, for their own reasons, wish to avoid regulation, selecting less-regulated jurisdictions. Consequently, less-regulated jurisdictions often become a target for money launderers and fraudsters.

To prevent the possibility of regulatory arbitrage, even on a short-term basis, the adoption of international standards should be seen as a global issue and not simply one of relevance to the Overseas Territories. Therefore, other jurisdictions should be encouraged to ensure that they introduce similar improvements and thereby facilitate a level playing field between jurisdictions.

The work of groups such as the Financial Stability Forum in raising global standards will be of importance in this area and should continue to receive strong support from both the UK and the Overseas Territories.

2.4.5 **Scope limitations and other related matters**

Our terms of reference do not provide for us to verify all the factual matters in this report, which would be a major and time consuming task. Instead, as agreed with the Steering Committee and set out in the TOR, we asked the Overseas Territories to provide us with information (including copies of relevant legislation) and to check various drafts of our reports for factual accuracy. This they have done. It should be appreciated that any further information not provided to us might alter our conclusions.

In a number of instances, sector information (for example total funds under management and analyses of a jurisdiction's main sources of business) is not collated by the jurisdiction and therefore was not available to us. In other cases available information is dated.

There was also, on occasion, a lack of available statistical information, particularly in relation to co-operation provided by the Overseas Territories to other jurisdictions. It appears that either this information is not available in a format that is retrievable to provide the statistics necessary, or it is not kept at all. The absence of such information has made certain comments on the level of co-operation provided by the Overseas Territories impossible to verify or refute. Recommendations to resolve this matter have been made in the report.

This report has been prepared for the sole purposes of a review of Financial Regulation in the Caribbean Overseas Territories and Bermuda for the Steering Committee comprising representations from the Foreign and Commonwealth Office, HM Treasury, Financial Services Authority and Governments of Bermuda, Cayman Islands and Anguilla ("the client"). It has been designed to meet the agreed requirement of the client and particular features of the engagement of KPMG determined by the client's needs at the time. This report should not therefore be regarded as suitable to be used or relied on by any person or organisation other than the client or for any other purpose or in any other context. Any person or organisation other than the client who chooses to rely on this report will do so at its own risk. KPMG will accept no responsibility or liability in respect of this report to any third party.

2.4.6 **Timescales**

Whilst we have noted areas where we consider action is required as a priority we have not set out specific timescales. We consider that the precise timescales are best determined bilaterally between the individual overseas territories and the Foreign and Commonwealth Office.

2.4.7 **Acknowledgements**

We are most grateful for the significant amount of time spent by representatives of the Overseas Territories, Her Majesty's Government and the other organisations whom we met.

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Prepared 27 October 2000

3 Regulatory authority

3.1 Introduction

As stated in the White Paper, a sound, transparent regulatory environment is necessary to maintain investor confidence and the reputation of the financial sector in a particular jurisdiction. This is only possible if the regulatory authority is, and is seen to be, independent.

In order to demonstrate this 'independence', the jurisdiction must be seen to meet international standards. These standards extend beyond simple independence to encompass such issues as resourcing and accountability. This theme is developed further below.

Our TOR cite four documents which provide specific details on what the international community expects from a regulatory authority. These documents are:

- Objectives and Principles of Securities Regulation issued by International Organisation of Securities Commissions ("IOSCO");
- Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision ("Basel");
- The Supervision of Cross-Border Banking by Basel and the Offshore Group of Banking Supervisors ("OGBS"); and
- Insurance Principles, Standards and Guidance Papers by the International Association of Insurance Supervisors ("IAIS").

These documents consider all aspects regarding the regulatory authority including licensing, supervisory and enforcement powers and the ability of the authority to co-operate with other regulatory and legal bodies.

In addition, the Guidance Notes introduce several concepts which are not explicitly referred to in the documents above but which are included in the scope of our review.

International co-operation and the powers of the regulator pertaining to the different financial sectors in the jurisdiction are dealt with elsewhere in this report.

This section deals solely with the consideration of the remaining principles relating to the regulator. The Supervision of Cross-Border Banking and the Insurance Principles, Standards and Guidance papers do not refer to this subject and, as such, their content has been excluded from this discussion.

3.2 Principles relating to the regulator

The following section sets out the criteria underpinning what constitutes a regulatory authority which is deemed to meet acceptable international standards and the implications for the jurisdictions under review.

The source of the information set out in this section is Basel principle 1, IOSCO principles 1 to 5 and the Guidance Notes.

The regulatory authority should have clearly defined responsibilities, be operationally independent and accountable, have adequate powers and resources, be consistent in its approach and observe the highest professional standards including upholding appropriate standards of confidentiality.

- Clear responsibilities

Ideally the responsibilities of the regulator should be set out in law and adequate legal protection should be provided to the regulatory authority and its staff. Legislation should be designed to avoid gaps or inequities in regulation.

- Independence and accountability

The regulator should be operationally independent from external political and commercial influence and be accountable in the use of its powers and resources. Independence is deemed to be enhanced by a stable source of funding and would be considered to be compromised by any marketing activities carried out. Approval of decisions made by the regulator, by the government or a minister does not necessarily constitute a lack of demonstrable independence providing any such consultation does not include decision making on regulatory matters.

- Powers and resources

The regulator must have adequate powers and the capacity to exercise its powers, including licensing, supervision, inspection, investigation and enforcement. In many cases these powers vary across the financial sectors represented in the jurisdiction and therefore these are considered in the relevant sections of this report.

In order to exercise its tasks, the regulator must be adequately funded with the level of funding reflecting the difficulty of retaining experienced staff. Training should be provided as required on an ongoing basis.

- Clear and consistent processes

The processes adopted by the regulator should be comprehensible, transparent, fair and equitable and consistently applied. On policy decisions, the regulator is expected to consult with those who may be affected; it is generally desirable to make public disclosure of policy. The regulatory authority should also play an active role in the education of financial service industry participants.

- Staff conduct

Staff of the regulator are expected to observe the highest professional standards and be given clear guidance on conduct matters including on conflicts of interest, use of information obtained, fairness and the observance of confidentiality provisions.

3.3 **Self-regulation**

IOSCO principles 6 and 7 advocate the use of self-regulatory organisations ("SROs") in appropriate circumstances, providing the SROs are subject to the continuous oversight of the regulator and observe similar standards of conduct to the regulator itself.

3.4 **Factual assessment**

3.4.1 **Clear responsibilities**

3.4.1.1 ***Constitutional position***

By virtue of Section 13(bb) of TCI Constitution, the responsibility for the regulation and supervision of international and offshore financial relations, resources and services is vested in the Governor.

Currently the Financial Services Commission ("FSC") is a government department within the Ministry of Finance with reporting responsibilities via the Permanent Secretary, Finance to the Minister of Finance on domestic issues and to the Governor on offshore financial service matters.

3.4.1.2 ***Regulatory structure***

The Head of the FSC is an overall Superintendent; there are roles for individual superintendents in each of the areas covered by regulatory licensing.

The FSC currently has regulatory responsibility for:

- banks;
- trusts;
- insurance; and
- company managers.

In addition, the FSC operates the Registry of Companies.

At present those firms providing securities and investment business services and those incorporating or operating collective investment schemes are not regulated.

3.4.1.3 ***Gaps in regulatory coverage***

Currently, regulation is not conducted in the following areas:

- mutual finds;
- company management; and
- securities and investment business.

The first two of these are covered by an Ordinance which has been enacted but is not yet in operation. These are discussed in sections 7 and 9 respectively.

There is no legislation in place covering securities and investment business. This subject is dealt with in detail in section 6 of this Report.

3.4.1.4 ***Immunity of regulators***

Immunity is afforded to the Permanent Secretary, Finance and the Superintendent of Company Management and the Superintendent of Mutual Funds by virtue of Sections 23 and 25 of the respective ordinances. This provides protection for acts carried out in good faith in the discharge or purported discharge of functions and powers.

Section 34 of the Trustees' Licensing Ordinance provides protection from personal liability for the Superintendent of Trustees, the Permanent Secretary, Finance and the Attorney-General but does not include acts in good faith in the purported discharge of functions.

No such provisions exist under the Banking or Insurance Ordinances.

3.4.2 **Independence and accountability**

3.4.2.1 ***Accountability***

The FSC is accountable to the Permanent Secretary, Finance on staffing, budgeting and operational matters and the Governor on offshore financial services issues. All decisions made by the department are potentially subject to judicial review.

3.4.2.2 ***Marketing responsibilities***

From 1 April 2000 the FSC has had no marketing responsibilities. From that date, marketing was undertaken by the Financial Industry Association ("FIA"), an umbrella organisation comprising all the private sector financial industry groups.

The FSC retains two peripheral duties in respect of marketing:

- monitoring the content of advertisements to ensure that public policy is not contravened; and
- receiving a budget and statement of expenditure in respect of the Government's financial contribution to ensure the FIA spend in accordance with the public expenditure appropriation.

3.4.3 **Powers and resources**

3.4.3.1 ***Introduction***

Those parts of the Guidance Notes which relate to powers and resources pertaining to international co-operation and the powers of the regulator in respect of the different financial sectors in the jurisdiction are dealt with in the sector specific sections of this report.

3.4.3.2 ***Staffing***

The FSC and Company Registry combined currently employ thirteen people with roles and responsibilities as follows:

- Superintendent of the FSC (also filling the vacant role of Superintendent of Trustees);

- Deputy Superintendent of FSC and Superintendent of Banking;
- Superintendent of Insurance;
- Superintendent of Company Management;
- Registrar of Companies;
- Deputy Registrar of Companies plus staff; and
- two staff providing administrative support.

In addition, there is a consultant from Companies House in the United Kingdom who is providing training.

The FSC has identified three vacant posts, funding for two of which has been approved. These posts are for a finance officer, an analyst and an insurance officer.

The role of Superintendent of Trustees is vacant but there are no plans to fill this post as it is not deemed to represent a full-time position.

There is also a lack of middle management resource which the FSC considers will be addressed once the finance officer and analyst are recruited.

3.4.3.3 ***Licensing powers***

Decisions on the issue and revocation of licences require the approval of either the Permanent Secretary, Finance or, in the case of banks, the Governor.

3.4.3.4 ***Training***

Relevant training has been provided in the last two years to all staff below the Superintendent and his deputy.

3.4.4 **Clear and consistent processes**

3.4.4.1 ***Involvement in legislative development***

The FSC plays a significant role in legislative development, particularly with regard to the production of briefing papers and consultation with the relevant industry groups.

3.4.4.2 ***Documented procedures***

The FSC does not currently have a procedures manual covering the key elements of its work, namely licensing, off-site review and on-site review.

3.4.4.3 ***Disaster recovery plan***

The Government has a national disaster recovery plan but there is no plan specific to the FSC.

3.5 **Issues and recommendations**

3.5.1 **Introduction**

The growth of the financial sector in TCI means that, in order to achieve its stated aim to fully comply with international standards, the FSC must now move to become an operationally independent regulator.

If this is achieved, and all the other matters highlighted in this report are actioned, we consider TCI will have clearly demonstrated its capability as an effective regulator at an international level.

3.5.2 **Regulatory independence**

In our view operational independence means the ability of the regulatory authority to act in the best interests of regulation (systemic, national and protection of customers) free from political and private sector interference (so avoiding the danger of regulatory capture) but with proper political accountability.

We therefore favour transferring the power of the Governor to grant and revoke licences to a new statutory body. We nevertheless consider this will only result in better compliance if it is accompanied with proper resourcing and accountability.

We consider that, in order to meet international standards, the FSC must therefore not only become an operationally independent body but that the following criteria also need to be met:

- it should have its own funding source. This would be achieved by the regulator being the initial recipient of licence fees, and passing on the surplus to the Government. In order to ensure efficiency, the regulator would be required to prepare budget forecasts and justify any variances by means of an annual report (which should be published); and
- a supervisory board should be established, to oversee the regulator. Part of its function would be the monitoring of efficiency. Membership of this board must be carefully constituted to ensure that there is not undue influence from either the public or private sector. Consideration should be given to including appropriate expertise from outside TCI to provide additional breadth in skills.

3.5.3 **Trans-national regulatory support**

Given the limited regulatory resources available, consideration should be given as to how best to maximise regulatory resource effectiveness within the constraints inevitable in a small jurisdiction.

We have considered whether it is practical or desirable to create a regulator which, like the Eastern Caribbean Central Bank, is trans-national. In this instance it would cover the Overseas Territories for whom the UK Government has ultimate regulatory responsibility, namely Anguilla, Montserrat and TCI.

We do not consider such an approach to be viable. This is partially due to the geographic distance between the jurisdictions but also because of the importance of having senior regulators present in the jurisdiction they are supervising.

Nevertheless, we consider that some pooling of regulatory skills would maximise the effectiveness of the regulatory resources available, enabling effective supervision to be undertaken on a cost effective basis. For example, one jurisdiction may have a significant insurance sector, so requiring a full-time experienced supervisor, while another may only have a small insurance sector and therefore may require a similarly skilled regulator but not have sufficient need for a full-time resource.

In order to create an effective regulatory environment this issue needs to be addressed. This can be achieved in a number of ways, including:

- greater co-operation between jurisdictions in sharing regulatory resources, particularly in respect of regulatory development projects (for example developing on-site supervision programmes);
- shared training;
- greater sharing of resources in the carrying out of investigations or dealing with major regulatory issues; and
- the use of secondments, from both smaller to larger centres to gain experience and from larger to smaller centres to enable skill sharing.

Such an approach would need to overcome a number of key factors including cost allocation and the competition between the jurisdictions for business (although the Overseas Territories are committed to avoiding regulatory arbitrage).

A current example of this is the work of the Anguilla Director of Financial Services in assisting the Regulator in Montserrat on a part-time basis.

We therefore recommend that consideration is given to assessing the merits of formalising of such a resource sharing process.

3.5.4 **Staffing**

The FSC is, by its own acknowledgement, under-resourced in certain areas. This view has been echoed by the recent CFATF Mutual Evaluation Report. This problem will become increasingly acute when the FSC commences on-site inspections.

The increase in resources should be accompanied by formal and thorough training in supervision, including the conduct of on-site inspections.

Three additional posts have been identified, and there is currently no-one fulfilling a dedicated role as Superintendent of Trustees. Furthermore, there appears to be no middle management in the organisation, with the Superintendents taking very much a hands-on role.

We recommend that the vacancies identified should be filled as a matter of urgency and that additional staff should be recruited to assist with the greater level of off-site and on-site monitoring advocated elsewhere in this report.

As an independent body the regulator would be in a position to recruit new staff and remunerate existing staff on a level equivalent to that of the private sector. Irrespective of any decision regarding an independent body, efforts must be made to ensure that remuneration of regulatory staff is comparable with the private sector in order to assist with the recruitment and retention of staff.

We welcome your comments on this site.

Prepared 27 October 2000

4 Banking

4.1 Introduction

There are established international standards in place concerning the regulation and supervision of banking. The Terms of Reference for this review require us to consider whether the arrangements for the regulation of banking conform to the standards outlined in the "Core Principles for Effective Banking Supervision" (the "Core Principles") produced by the Basel Committee on Banking Supervision ("Basel Committee"), together with the report by members of the Basel Committee and members of the Offshore Group of Banking Supervisors on the "Supervision of Cross-Border Banking".

The Core Principles comprise 25 basic principles required to be in place for a supervisory system to be effective. The Principles cover:

- preconditions for effective banking supervision (Principle 1);
- licensing and structure (Principles 2 to 5);
- prudential regulations and requirements (Principles 6 to 15);
- methods of ongoing banking supervision (Principles 16 to 20);
- information requirements (Principle 21);
- formal powers of supervisors (Principle 22); and
- cross-border banking (Principles 23 to 25).

The requirements relating to cross border banking were developed by the report "Supervision of Cross-Border Banking". This detailed the requirements for effective home and host banking supervision in order to facilitate effective consolidated supervision including the associated necessary information flows between regulators.

Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

It is against the above standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.`

4.2 Type and scale of activity

As at the end of March 2000, there were eight banks licensed by the Financial Services Commission ("FSC"), holding total deposits of US$539 million and total assets of US$618 million.

The FSC is the home supervisor of three banks, which have no foreign branches or subsidiary operations.

The bulk of deposits are held by two branches of international banks from the UK and Canada. There is also a branch of a Canadian bank incorporated in the Bahamas. Of the remainder, three are locally incorporated banks and two are subsidiaries of financial institutions from Belize and Panama respectively.

Five of the banks have combined licences (national and overseas) entitling them to conduct both local and offshore business, while the other three have licences to conduct offshore business only. Two of the offshore banks have no physical presence ("cubicle operations"- colloquially known as "brass plate banks") and are administered by a local service provider and accountancy firms in Panama and Venezuela.

According to the FSC, the main business of the offshore banks is deposit taking and the provision of banking services to high net worth individuals from the Americas. Local retail banking services are provided by the national banks.

4.3 **Factual assessment**

4.3.1 **Legislation**

Banks in TCI are licensed and regulated by the Banking Ordinance 1979 (the "Ordinance"), as amended. A Banking (Special Provisions) Ordinance exists but is in abeyance.

The Ordinance provides that no person or company shall carry on banking business from within TCI, whether or not such business is carried on within or outside the jurisdiction, unless the person or company has obtained a licence pursuant to the Ordinance.

There are two types of Banking licence granted under the Ordinance.

National Banking Licences permit banks to conduct business in and from TCI with TCI citizens and with those who are ordinarily or temporarily resident. Overseas Banking Licences enable banks to conduct business from within TCI but not with those who are resident.

Conditions may be and are attached to banking licences. Banks may hold either or both types of licence provided that segregated accounting or a separate entity is utilised.

The legislation imposes a maximum level of related party transactions, acquisitions and concentration of assets at 25% of total assets.

4.3.2 **Regulations**

The rules and regulations under which banks are required to operate are contained in the Ordinance, the First Schedule and the Regulations.

The First Schedule covers the procedure for licence applications. The Regulations cover areas such as duties of reporting and prior notification.

There are a number of anomalies in the primary and subordinate legislation of which the most important are the:

- definition of required capital in the Ordinance (Section 8) which focuses on meeting liabilities as they fall due rather than on net assets;
- requirement for liquidity where a minimum is also a maximum (Section 19);
- apparent conflict in the First Schedule between prior approval in changes in ownership and the appointment of senior officers and the requirement for notification of these to the FSC; and
- apparent conflict between section 20(3) of the Ordinance and Paragraph 7 of the Regulations with respect to access to customer details.

The FSC indicated that it intends to revise the Ordinance within the next six months and that these anomalies will then be amended.

4.3.3 **Guidance notes**

There are guidance notes currently in place relating to licensing.

The FSC has not issued any other guidance specific to banks but is currently encouraging the establishment of a Bankers' Association to act as a consultative body to liaise with, prior to the issue of guidance notes.

4.3.4 **Supervision - systems and procedures**

4.3.4.1 ***Regulatory structure***

National Banking Licences are granted by the Governor in Council, whereas Overseas Licences are granted by the Governor. In both cases, recommendations are made by the Superintendent of Banking. Revocation powers are exercised by the Governor in Council and Governor respectively.

Day-to-day regulatory supervision is undertaken by the Superintendent of Banking within the FSC.

The Superintendent has access to support within the FSC but has no dedicated assistant.

4.3.4.2 ***Application process***

The TCI has a public policy that a bank will only be considered for licensing if the following criteria are met:

- it is predominately locally owned; or
- it is a branch or subsidiary of a bank with a well-established and proven track record and which is subject to effective consolidated supervision by their home supervisory authority; or,

in the case of an application for a restricted licence only:

- it is a bank, which, although not a subsidiary, is closely associated with an overseas bank, and which, by agreement, will be included within the consolidated supervision exercised by the overseas bank's home supervisory authority; or
- it is a wholly owned subsidiary of an acceptable non-bank corporation whose shares are quoted on a recognised stock exchange where the objective of the subsidiary is to undertake in-house treasury operations only, and where the operations are fully consolidated within the published financial statements of the parent company.

Banks must also demonstrate "mind and management" in the jurisdiction of incorporation unless they are a subsidiary and the "mind and management" is located in the jurisdiction where consolidated supervision is undertaken.

The terms and conditions for applications for licences are set out in the First Schedule to the Ordinance and in Guidance Notes issued by the FSC. They include requirements for:

- a list of all persons, with their addresses and nationalities, who are registered shareholders of the applicant, distinguishing the shareholdings of each, and a list of all persons, with their addresses and nationalities, who are beneficial owners of shares in the applicant but not registered shareholders, distinguishing the shares of which each is such a beneficial owner, and two or more references verifying the financial good standing of each such shareholder or beneficial owner or person who is a natural person;
- three references, one of which shall be financial in nature from a bank or trust company in respect of all the persons who are directors (not to be less than two), managers or senior officers of the applicant;
- a statement of the assets and liabilities of the applicant at the end of the month prior to the lodging of the application; and
- a business plan which shall set out details of the commercial operations in which the applicant intends to engage if a licence is granted and which shall include the following information:
- the business objectives of the applicant and the type and source of business contemplated;
- the applicant's proposed initial assets and its anticipated assets and liabilities and estimated income at the end of each of the two years next succeeding in the grant of the licence;
- particulars of the applicant's management structure and personnel;
- the reasons for the selection of the Islands as a place for the conduct of the applicant's business; and
- particulars of the applicant's customer base.

The application process includes a requirement for the consent of the home supervisor who must exercise consolidated supervision and co-operate in sharing regulatory responsibility with the FSC. The FSC also considers the capability of the overseas regulator to conduct consolidated supervision.

In the past three years, five out of eight applications have been declined. Four of these were on the grounds of fitness and probity and the other because it appeared that the applicant was seeking to establish a parallel bank. Refusals of licences are not subject to appeal or review.

4.3.4.3 ***Off-site supervision***

The supervision of banks is primarily achieved through the examination of monthly and quarterly returns. The scope and timing of these returns is defined by Section 20 of the Ordinance.

The returns required relate to financial information and the FSC has advised that it is based upon the Bank of International Settlements standard model, modified to meet TCI's requirements.

At present, compliance by banks with the terms of the Ordinance is assessed by the annual certification provided by the directors and the integrity of financial returns is assessed against the audited accounts which must be produced, published in the Gazette and audited by a firm of approved auditors.

We understand that the Superintendent intends to involve the auditors more specifically in monitoring compliance.

The Superintendent has also held a number of meetings with senior management of licence holders to discuss their operations and future plans.

4.3.4.4 ***On-site inspection***

The FSC is developing an on-site inspection capability subject to resource constraints. One on-site examination has taken place in conjunction with a home regulator. There is, however, no current ongoing programme of on-site inspections.

Whilst there are restrictions imposed by Section 20(3) on customer information the Superintendent may be able to access such information if required via Section 3 of the Confidential Relationships Ordinance or Paragraph 7 of the Banking Regulations.

4.3.4.5 ***Ongoing requirements***

Books and records

All banks are required to maintain proper accounting records in accordance with either international, UK, USA or Canadian accounting standards. It is a requirement that all licensees report to the Superintendent on a regular basis, and an auditor must audit the financial statements of the banks on an annual basis. There is a requirement that the auditor be approved by the Permanent Secretary of Finance.

There is no statutory requirement for banks to retain records in the jurisdiction. Currently two banks do not maintain their books and records in TCI.

Authorised Agents, Principal Office and Managed Banks

All banks without a head office in TCI are required to have a principal office and two authorised agents located in TCI.

There is no requirement in the Ordinance for the authorised agents to be approved.

The Governor may exempt a bank from this requirement if its banking business is being managed from TCI by:

- another licensee which maintains a principal office in TCI; or
- a person or group of persons, resident in TCI suitably qualified and approved by the Governor.

Capital adequacy

Whilst there is no minimum capital requirement for banks, the Superintendent calculates capital adequacy ratios and requires a minimum 10% of risk-weighted assets. The lowest figure at the last return date was 18%.

Large exposures

The TCI is aware of the Large Exposure issue and connected lending information is captured. The Ordinance sets a maximum of 25% of assets for such exposure. There are, however, no regulations or guidance in relation to this matter.

Derivatives/off balance sheet instruments

Banks engaged in derivatives and other off balance sheet instruments are expected to have appropriate policies and procedures in place. No guidance has, however, been issued to banks regarding the use of derivatives and other off balance sheet instruments.

Anti-money laundering

Licence holders are subject to the anti-money laundering legislation and the Proceeds of Crime (Money Laundering) Regulations, which cover, *inter alia*, "know your customer" requirements.

Breaches of the anti-money laundering legislation or regulations do not currently automatically represent a disciplinary offence by the licence holder. Therefore, at present the Superintendent has no automatic power to take action against a licence holder for such a breach. However, the bank may be subject, indirectly to such action as it could be considered to be "carrying on business contrary to the public interest".

4.3.5 Enforcement - systems and procedures

The main sanction currently available to the Superintendent is recommending to the Governor the revocation of a licence.

This may be applied under a number of circumstances, including for any contravention of the Ordinance or where the licence holder is carrying on business detrimental to the public interest.

The Governor also has powers under section 24 of the Ordinance to deal with a problem bank but only after a special examination under section 22. These powers include:

- to require the licence holder to take remedial action;
- appoint a person to act as adviser to the licence holder; and
- to debar a person from acting as a director or manager.

4.3.6 Depositor protection schemes

There is no depositor protection scheme in TCI.

4.4 Issues and recommendations

4.4.1 Introduction

The TCI is in the process of developing its regulatory approach to banking and we consider the efforts being made as a positive feature of TCI's regulatory environment. The FSC accepts that, whilst a number of Basel Principles are being complied with, further work is necessary in order to create a regulatory regime that is fully in compliance with international standards.

The issues detailed below highlight the principal areas where attention should be focused.

In addition Basel Core Principle 1 requires operational independence and adequate resources for the regulator. The TCI is not currently in compliance with this Principle. This is covered in the previous section to this report and therefore is not repeated here.

4.4.2 Licensing

Whilst relevant information is being received in respect of applications our on-site review was unable to validate the vetting procedures or assessments carried out in respect of operating plans, financial or projected profits. Such an assessment is required to fully comply with Basel Core Principle 3.

We therefore recommend that a documented and structured assessment process is instituted for future applications.

We note that the FSC makes use of regulations to impose a requirement relating to changes in beneficial ownership prior to its occurrence. However section 7(3) of the Banking Ordinance appears to impose an "ex post facto" reporting and approval requirement. This difference could potentially result in legal challenge to the FSC's approach.

We therefore recommend that the Ordinance is amended to reflect actual practice, which reflects better practice.

In addition we note that the Ordinance does not formally require fitness and probity checks to be undertaken in assessing a licence application. The only conditions imposed are that the applicant is qualified to carry on banking business and that the application is not against the public interest.

We therefore recommend a revision to the Ordinance which places the obligation of being "fit and proper" on a statutory footing.

4.4.3 **Legislation**

We agree with the FSC that the requirements in the current Ordinance require updating to bring them fully in line with Basel principles.

The definition of banking business in the Ordinance is generally satisfactory though the FSC is concerned about possible perimeter problems in the trust company and mortgage business areas. Banking names are controlled but there is also a rather anomalous provision which requires licence holders to incorporate the word "bank" in their business name. Anomalies in primary and secondary legislation should be addressed in respect of:

- required capital;
- liquidity;
- prior approval/notification requirements; and
- access to client files.

We further consider that the 25% asset limit on areas such as related party transaction should be removed. The permitted level should be a matter for regulatory discretion thus allowing a lower level to be set where appropriate.

4.4.4 **Access to and sharing of information**

The Superintendent is able to share a significant amount of information with foreign regulators by virtue of the gateway contained in subsection 29 (i) of the Ordinance. However, the restriction on access to depositor information contained in subsection 20 (3) of the Ordinance means TCI does not appear to fully meet the principles in the Basel Cross-Border Supervision paper. For example, paragraphs 4, 5 and 18 of this paper all refer to the need, for effective regulation to be achieved, for regulators to have access to all information, including client-specific information.

Subsection 20(3) of the Ordinance bars the Superintendent from access to information about a particular customer. Whilst paragraph 7 of the Regulations does not contain this restriction we consider that this anomaly may result in the necessary information not being available.

We believe that subsection 20(3) needs to be amended as a priority to permit access to depositor information and so enable the relevant Basel standards to be met.

Such access is also needed to permit effective on-site monitoring, particularly verifying compliance with the "know your customer" and other requirements for the prevention of money laundering.

4.4.5 **Off-site supervision**

The Banking Superintendent appears to enjoy a good relationship with the banking industry. Additionally the Ordinance provides the powers to seek the necessary information to meet the relevant Basel standards. There remain, however, some important areas where we consider the off-site supervisory approach is in need of enhancement.

These are:

- The Superintendent should set requirements to prevent abuses of connected lending (core principle 10). The Superintendent collects such information, and is aware of and monitors exposures. However, there are no requirements set in this area apart from the 25% limit;
- At present TCI-licensed banks are not required to produce proper risk management policies and procedures and adhere to them. This should be made a requirement. Given the policy of limiting entry to the jurisdiction to the branches and subsidiaries of major international banks, TCI banks will have their parents' expertise to draw on in this area; and
- Banks should be required to maintain and submit on request up-to-date business plans. This will enable the Superintendent to ensure that he is able to be kept appraised of the current and proposed operations of the bank.

Additionally, while we recognise that the Superintendent has meetings with licence holders, we consider that these should be extended to include a formal prudential meeting at least once a year with each of the banks and their auditors to discuss, *inter alia*, business plans, variance from previous business plans and reasons for the variance. The meetings should be formally structured and documented.

4.4.6 **On-site inspection**

We support the decision by the FSC to commence on-site inspections.

Such a programme should, if undertaken thoroughly, seek to address the following weaknesses in the current regulatory regime and satisfy the stated Basel Principles including:

- carrying out an evaluation of a bank's policies, practices and procedures for loans and investments (Principle 7);
- ensuring that banks have policies, practices and procedures for evaluating the quality of assets and adequacy of loan loss provisions and loan loss reserves (Principle 8);
- being satisfied that management information systems are in place to identify concentrations (Principle 9);
- being satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk, market risk and transfer risk (Principles 11 and 12);
- ensuring that banks have comprehensive risk management processes in place (including board and senior management oversight) (Principle 13);
- ensuring that banks have comprehensive adequate internal controls (Principle 14);
- ensuring that banks have adequate policies, procedures and practices including "know your customer" (Principle 15).

Whilst elements of the above areas can be and, in places, are being achieved through off-site supervision, we consider on-site verification is vital for full compliance to be achieved.

We recommend that the Superintendent commences on-site inspections by the end of 2000. We also recommend that the programme ensures that all licensed banks are inspected during 2001 and that a risk based visit programme be introduced with an average cycle of three years.

We further recommend that the on-site visits include the two banks without books and records or "mind and management" in TCI ("Cubicle Banks").

4.4.7 **Enforcement powers**

We agree with the FSC that the current enforcement powers available are significantly too limited to deal with the variety of potential situations that may be faced by a regulator.

We therefore recommend that the following additional powers are introduced:

- to apply to the court for the winding up of a licence holder (the power to wind up a former licence holder is contained in the companies Ordinance);
- to impose additional conditions on a licence (though this may be covered by the Governors' general powers under section 24 of the Ordinance) to require a licence holder to take remedial action;
- to replace a director or officer; and
- to appoint a manager/custodian to take over a bank's activities and/or protect depositors assets.

In addition, we consider that the Superintendent should have express powers to "police the perimeter" and be able to investigate suspected breaches of the Ordinance.

4.4.8 **Principal Office, Managed Bank and Authorised agents**

We consider the role of the authorised agent to be important, particularly when it is the representative of a licence holder

with no mind and management in TCI and therefore is the first point of contact for the regulator. Therefore, it is essential that it is competent to undertake this role and are exercising proper diligence in their task. We therefore consider that authorised agents should be subject to prior approval by the Superintendent.

Similarly, there is a need to clearly specify the duties of someone providing managed bank services to ensure that the services are being provided in a prudent manner.

We therefore consider that TCI should issue a formal code to authorised agents and those managing banks detailing what is expected of them in the undertaking of their duties. In addition we consider that the Superintendent should undertake reviews of authorised agents to verify compliance with this code.

This code should cover, *inter alia*:

- what information about the bank the agent is expected to have;
- what ongoing due diligence checks and other monitoring the agent should undertake;
- duties of reporting to the Superintendent; and
- duties relating to any other services provided by the agent (e.g. directors).

4.4.9 **International co-operation**

The effective regulation of banks on a consolidated basis relies upon the regular interflow of information between regulators in different jurisdictions. As a host jurisdiction TCI has an important role in this.

We consider the fact that the FSC has signed a Memorandum of Understanding ("MOU") with all but one home supervisor (which declined, preferring informal arrangements between supervisors) as a positive factor in TCI's regulatory environment. The TCI needs to ensure it is proactive in maximising the effect of these MOUs through the ongoing and immediate sharing of information pertinent to consolidated banking supervision.

The jurisdiction that declined the request for an MOU should again be approached to assess whether regulatory information flows (both from and to TCI) could be achieved through another process.

4.4.10 **Anti-money laundering**

Whilst we accept that the breach of the anti-money laundering code could be considered "carrying on business contrary to the public interest", we consider that, to make the position absolutely clear, a breach of any anti-money laundering laws, codes, guidance or regulations should formally be grounds for disciplinary action against a licence holder, including possible revocation of its licence.

4.4.11 **Role of the auditor**

There is currently no provision within the Ordinance providing a gateway for the auditor to disclose information on a licence holder to the Superintendent nor is there an obligation imposed on the auditor to report certain matters or events to the Superintendent.

We therefore recommend that a duty of reporting combined with an exemption from the general duty of confidentiality in such reporting would be valuable and should be included in a revision to the Ordinance.

Additionally, there should be annual prudential meetings with the auditor and licence holder. This meeting should cover, *inter alia*, development of the bank's business plan.

4.4.12 **Guidance notes**

The lack of formal guidance notes is not in line with best regulatory practice. We therefore support the FSC's intention to develop such guidance.

Guidance notes are generally used to disseminate policy and reporting requirements to banks. They lack the legal force of regulations but should carry the same import. If they are not complied with, sanctions are usually necessary.

Areas such as risk management policies and procedures, liquidity management, Basel capital rules, large exposures and

derivatives are all topics deserving regulatory attention and, in our view merit guidance notes. Risk diversification (e.g. by location, by industry, by instrument, by currency, by counterparty, etc.) is an additional topic that can usefully be covered in guidance.

We welcome your comments on this site.

Prepared 27 October 2000

5 Insurance

5.1 Introduction

The International Association of Insurance Supervisors ("IAIS") has produced a number of principles and standards set out in a series of papers and approved by its members.

These standards recognise that the regulatory framework for insurance supervision varies from country to country and are not mandatory and do not necessarily reflect current practice in all of the member countries. The principles and standards are intended to represent a target for supervisors to work towards and can be implemented in a flexible manner depending upon the circumstances of each jurisdiction.

The Offshore Group of Insurance Supervisors ("OGIS") has also introduced a set of principles, standards and guidance notes upon which self-assessment is required. Conditions of membership of this group include having legislation in place which enables its regulatory authority to adequately supervise insurance business by having the necessary resources and properly qualified supervisory personnel to enforce the legislation.

Of the territories under review, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of OGIS, with Anguilla having observer status.

The TOR for this review require us to assess performance against International Standards and good practice in the insurance sector.

It is against these standards that we have made our assessments. The areas where it is considered that development may be required are contained in the issues and recommendations section of this report.

5.2 Type and scale of activity

The TCI can be regarded, certainly in terms of active licences, as one of the world's largest offshore insurance centres. Numbers of PORCs continue to grow rapidly and TCI is a leading offshore credit life insurance centre.

No statistics in relation to premiums, assets or liabilities are available. We are informed that this is a consequence of the exemptions afforded to PORCs, whereby such companies are only required to make an annual compliance statement signed by their chief operating officer.

The Superintendent of Insurance has supplied the following data relating to the calendar year 1999:

	Number	
Offshore Insurance Companies	48	(Third party direct writing)
Captive Insurance Companies	73	
Credit Life Captive Insurance Companies /Producer Owned Reinsurance Companies	2,322	
Mortgage Guarantee/Motor Warranty	56	
Domestic Insurance Companies	13	(Two locally incorporated)
	2,512	
New licences issued in 1999	243	(of which 227 Credit Life)

5.3 Factual assessment

5.3.1 **Legislation**

The following insurance legislation applies:

5.3.1.1 ***Insurance Ordinance 1989***

The Ordinance covers the Superintendent of Insurance, his duties and powers, licensing, annual returns and general provisions including secrecy, licence revocation and the ability of the Governor to make regulations.

Minor amendments to the Ordinance were made in 1990, 1992 and 1993. Changes in the Ordinance in 1994 were made providing exemptions from various sections for PORCs. In 1995, an amendment was made to include a preservation of secrecy clause.

5.3.1.2 ***Insurance Regulations 1990***

These Regulations cover application procedures, the power to exempt external insurers, the prohibition of bearer shares and regulatory issues.

5.3.2 **Rules, regulations and guidance notes**

5.3.2.1 ***Powers***

The legislation provides wide discretionary power to the regulatory authority which rests with the Permanent Secretary, Finance. In accordance with the Ordinance, the Superintendent is responsible for day-to-day regulatory activity. Powers are reserved to the Permanent Secretary, Finance to determine matters including granting, suspending and revoking licences and exercising discretionary powers, where these are granted by the Ordinance.

5.3.2.2 ***Exemptions***

Section 7(11) of the Insurance Ordinance permits the exemption of certain companies from recognised reporting procedures.

Considerable flexibility exists within the Ordinance and Regulations giving the regulator powers to exempt from statutory monitoring requirements and, where the Permanent Secretary, Finance considers it appropriate, that certain regulations need not be applied.

5.3.2.3 ***Licensing***

Guidelines on the issue of insurance licences appear as Regulation 6 of the Insurance Regulations. However, to adopt a flexible approach the Superintendent of Insurance may recommend that certain companies with particular characteristics be allowed to operate under modified regulatory requirements, following a satisfactory assessment of the risks involved.

5.3.2.4 ***Capital requirements***

The guidelines for capital requirements state that companies engaged in reinsurance and general business should expect to have a minimum paid up capital of US$100,000. Most PORC companies are capitalised at no more than US$50,000, although they may have trust/custodial agreements for greater sums in place within the United States. The minimum capital requirements for companies engaging in long term business is US$ 180,000.

5.3.2.5 ***Disclosure of information***

Guidelines were issued in April 1997 for the disclosure of information to an overseas regulatory authority. These guidelines appear in the Insurance Ordinance.

5.3.3 **Supervision - systems and procedures**

5.3.3.1 ***PORCs***

PORCs are usually owned by producers of credit related insurance who provide insurance products to their customers whereby credit is arranged in sales transactions from motor dealerships, retailers and finance companies. Credit life insurance settles the outstanding debt if the insured borrower dies, is disabled, or becomes unemployed. The direct writing insurance company in the USA, where the business originates, reinsures a portion of the business produced by the dealership with an insurance company in TCI. We are informed that the reinsurance relationship is regulated by various state

regulations and is subject to the mandatory trust or custodial agreement which is under the control and administration of the primary writer.

In the application for a TCI PORC insurance company licence, a standard business plan is common to all applicants.

An Annual Compliance Certificate is completed by the Chief Executive of the PORC who is required to confirm that no changes have occurred during the year. Normal captive insurance companies, i.e. non 7(11) insurers, are required to comply with all statutory returns as detailed in section 9 of the Ordinance.

5.3.3.2 ***Non 7(11) insurers***

With regard to non 7(11) captive insurance companies, and direct writing insurance companies, off-site supervision is performed by the analysis of statutory financial returns.

The information gained from completion of the various reporting forms under the Insurance Regulations, provides sufficient information to review the domestic insurance industry. The Superintendent of Insurance is an experienced insurance technician and confirms that underwriting procedures and reinsurance programmes are reviewed and approved.

We are informed that local on-site visits take place as and when it is deemed necessary. The last such inspections took place in 1998/99.

5.3.4 **Enforcement - systems and procedures**

The Insurance Ordinance and Regulations provide powers of enforcement including the power to investigate and intervene in the activities of the licence holder. The Permanent Secretary Finance has the sole power to suspend and revoke licences. During the past five years several companies have had their licences revoked.

5.3.5 **Policy holder protection schemes**

There are no policy holder protection schemes in force.

5.4 **Issues and recommendations**

5.4.1 **Introduction**

The insurance industry in TCI has been built upon the growth of PORCs which the jurisdiction feels are instrumental in developing the financial services industry.

5.4.2 **Supervision of PORCs**

Significant emphasis is placed upon, and attention paid to, the PORC product. This has been the major growth area for some time, and this growth is expected to continue.

Considerable regulatory exceptions are available to PORCs. Once licensed, these companies are not required to supply any audited accounts or other periodic reporting information other than an annual compliance certificate which is signed by a representative of the company itself. However, the FSC Guidelines for Credit Life Reinsurance Companies 1998 do make it mandatory for such companies to immediately notify the Superintendent of Insurance of, *inter alia*, any material changes to the business plan, change to the primary writer or change in beneficial ownership.

The IAIS Working Group on Reinsurance in its paper issued in February 2000 had amongst its conclusions that "arguments supporting direct supervision of reinsurers are stronger than those that do not promote direct supervision". Whilst this paper does not reflect the views of IAIS, IAIS considers it may serve as a good foundation for continuing world-wide discussions on reinsurance supervision. Furthermore, PORC companies are licensed, regulated and supervised in the same manner as other captive insurance companies, without any exemptions, in a number of other jurisdictions.

Whilst TCI has elements of direct supervision, we consider that, in line with developing international standards in this area, TCI needs to re-examine its approach to supervision.

On the basis that the capacity exists in TCI to vary standards of insurance supervision for PORCs, it is difficult to assess the degree to which compliance with IAIS Principles is achieved. In our view the flexibility possible in regulation does not accord with good practice.

In our opinion, ongoing supervision which is currently based on notification requirements and self-certification of compliance by an officer of the operating company itself now needs to be developed.

We recommend that the exemptions permitted under Section 7(11) now need to be reviewed and that PORC companies should be supervised and regulated with all other captives.

We understand that PORCs produce financial data returns which are filed with the Internal Revenue Service in the US as part of the US tax return compliance scheme. We would suggest that a financial data return filing with the Superintendent of Insurance becomes a requirement. This will assist the Superintendent in his offshore review.

Furthermore we recommend that any reliance placed on other regulatory bodies be formally codified and agreed with those bodies to ensure that there is effective and efficient regulatory coverage in all aspects of the PORC's operation wherever located.

Finally, in our opinion certification of compliance should be enhanced. To achieve this we recommend that the compliance certificate should be the responsibility of, and completed and signed by, the Registered Representative of the PORC, so providing verification by a third party rather than by the company itself.

5.4.3 **On-site inspection**

There are a considerable number of offshore insurance companies involved in direct writing of insurance business in various overseas countries. Whilst the pure captives and association captives writing the business of their owners do require some limited supervision those direct writing companies require total regulatory controls and supervision, including detailed on-site inspections which currently do not take place (other than on an *ad hoc* basis) and would be difficult, if not impossible, to perform with such limited staff resources.

We recommend that because of the resource limitations, priority should be given to the establishment of procedures to obtain information relating to the underwriting policy, reinsurance programme, claims management and reserving policies and record keeping, as a first step towards more effective on-site supervision.

5.4.4 **Reliance on the work of third parties**

In respect of companies not exempted by virtue of section 7(11) of the Insurance Ordinance, considerable reliance is placed on the insurance managers, the principal insurance representatives and the auditors in relation to compliance with the Ordinance. In particular, the auditor must provide an opinion regarding financial statements prepared in accordance with generally accepted accounting principles, on the company's certificate of compliance and on the statement of solvency.

The work carried out by these third parties forms an integral part of insurance supervision in the jurisdiction, particularly in light of current resourcing issues. From a limited review of files it would appear that periodic information and returns are not being received and filed on a timely basis. We recommend that, in order to demonstrate an appropriate degree of supervision, this information is obtained in accordance with part V of the Ordinance.

Furthermore, we consider that a legal requirement on auditors to report events which would adversely affect the viability of the insurance licence holders would enhance off-site supervision and would recommend that such a requirement be given due consideration by the regulator.

5.4.5 **Enforcement powers**

Whilst the power of enforcement and sanctions are provided by the Insurance Ordinance, in particular in section 15 where there are reasonable grounds for believing that circumstances exist, or are likely to arise, constituting grounds for suspension of a licence and in section 19 which provides for fines and imprisonment, it is considered that these are less than adequate in respect of intermediate powers.

We therefore recommend that the range of powers under the Ordinance be amended to cover intermediate stages, where an offence has not been committed and where a licence would not be revoked or suspended in normal circumstances, but where full compliance with the Insurance Ordinance cannot be demonstrated, for example a fine for the late submission of a company's annual return.

We welcome your comments on this site.

Prepared 27 October 2000

6 Securities / investments

6.1 Introduction

There are laid down international standards in place concerning the regulation and supervision of those involved in the securities and investments sector. The TOR for this review require us to look at whether the arrangement for the regulation of securities and investments conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

The relevant IOSCO Principles for this Section include:

- the responsibilities of the regulator should be clear and objectively stated (Principle 1);
- the regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. (Principle 3);
- the regulator should adopt clear and consistent regulatory processes (Principle 4);
- the regulator should have comprehensive inspection, investigation and surveillance powers (Principle 8);
- the regulator should have comprehensive enforcement powers (Principle 9); and
- the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme (Principle 10).

It is against the IOSCO standards that we have primarily made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

For the purpose of this report we have defined securities/investment business as covering the following range of activities:

- dealing in securities;
- arranging deals;
- investment management; and
- investment advice.

6.2 Type and scale of activity

We have been informed by the Financial Services Commission ("FSC") that three companies are carrying out securities and investment business in the jurisdiction. Of these two are local companies which are affiliated to trust service providers and the other is a locally incorporated subsidiary of an international broking firm.

The three firms employ approximately 20 persons among them. All three offer discretionary, advisory and execution only broking services, concentrated on private clients. The two of these that are trust company affiliates also offer locally managed mutual funds.

6.3 Factual assessment

6.3.1 Legislation

There is no regulatory legislation currently in place covering securities and investments business. Nor is there legislation which makes either insider trading or market manipulation a criminal offence.

The only piece of legislation which has relevance in this area is the Mutual Funds Ordinance 1999 which is not yet in

operation and is dealt with in the next Section to this Report.

The FSC have indicated that there are plans to introduce a licensing regime but the work required to instigate this is at a very early stage.

6.3.2 **Regulation/guidance notes**

As no legislation is in place covering the regulation of investment/securities activities, there are no regulations or guidance notes currently in place.

6.3.3 **Supervision and enforcement - systems and procedures**

As no legislation is in place covering the regulation of investment/securities activities, there are no supervision or enforcement procedures in place.

6.3.4 **Investor compensation schemes**

There is no investor compensation scheme in place relating to investment/securities business.

6.4 **Issues and recommendations**

6.4.1 **Introduction**

Whilst we have been advised that there is only a limited amount of investment/securities business currently being undertaken in the Turks & Caicos Islands, this may well increase as the islands continue to develop their financial service activities.

It is the FSC's belief that since such activity is limited it can, to a certain extent, be controlled by the requirement, that anyone wishing to engage in investment or securities business, to hold a business licence under Section 3 of the Business Licensing Ordinance. However, the FSC agree that this Ordinance covers persons wishing to engage in business generally and is a licensing rather than a regulatory regime and does not focus on the conduct of the licensed business.

The absence of an adequate legislative and regulatory framework for securities and investment business means that TCI is not in compliance with international regulatory standards as set out by IOSCO. We consider that this deficiency needs to be addressed.

6.4.2 **Legislation and regulation relating to securities and investment business**

We consider that TCI need to introduce legislation covering the regulation of securities and investment business and develop an appropriate regulatory regime.

As a first step, the FSC needs to contact all persons holding a business licence under Section 3 of the Business Licensing Ordinance, in order to establish the size and scope of activities conducted. The extent and nature of this activity will assist in determining the priority required for introduction.

Legislation needs to be put in place to regulate investment business, covering licensing, supervision, monitoring and information sharing. Licences granted under such legislation should be discrete from all other licences to prevent activities being excluded from regulation and supervision by virtue of the other activities carried out by a particular entity.

In addition to those elements referred to above the legislation should provide for legislation covering, *inter alia*, the handling of client money and investments and conduct of investment business.

The overriding principles which need to be considered in legislative drafting are those set out in the IOSCO Objectives and Principles of Securities Regulation.

The priority given to introducing the necessary legislation will depend upon the nature and scale of the activities being undertaken. However, in any event, we believe that the necessary regulatory regime should be in place by the end of 2001.

There is also a need for TCI to introduce legislation criminalising insider trading and market manipulation.

Not only might these offences be undertaken in or through TCI but also the lack of appropriate laws mean that they do not form part of the offences covered by TCI's anti-money laundering laws as they are not predicate offences (see the anti-money laundering section to this Report for details).

6.4.3 **Supervision**

We consider that any on-site supervisory regime developed for managers should pay particular attention to the methodology for supervising licence holders with no real presence in the TCI.

We welcome your comments on this site.

Prepared 27 October 2000

7 Mutual Funds

7.1 Introduction

There are laid down international standards in place concerning the regulation and supervision of collective investment schemes/mutual funds (referred to hereafter as mutual funds). The TOR for this review requires us to look at whether the arrangement for the regulation of mutual funds conform to the standards outlined in the International Organisation of Securities Commissions paper "Objectives and Principles of Securities Regulation". Standards are also contained in the Guidance Notes in respect of "The Supervision of the Banking, Insurance and Securities Sectors".

Among the IOSCO Principles there are specific principles relating to collective investment schemes; these are:

- that the regulatory system should set standards for the licensing and the regulation of those who wish to market or operate a collective investment scheme (Principle 17);
- the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client money and assets (Principle 18);
- regulation should require full, timely and accurate disclosure of financial results and other information which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme (Principle 19); and
- regulations should ensure that there is a proper and disclosed basis for asset valuation and the pricing and redemption of units in a collective investment scheme (Principle 20).

Other Principles, particularly regarding the regulator, enforcement and co-operation also apply to the regulation and supervision of schemes.

It is against those standards that we have made our assessment. The areas where we consider development is necessary are contained in the issues and recommendations section below.

7.2 Type and scale of activity

The number of mutual funds either incorporated or otherwise operating within the jurisdiction was approximately ten as at 14 March 2000 according to statistics supplied by the Financial Services Commission (the "FSC"). This data is an estimate as the legislation covering this activity is not yet in force.

The jurisdiction permits the use of companies, unit trusts and partnerships as mutual funds.

7.3 Factual assessment

7.3.1 Legislation

The Mutual Funds Ordinance 1998 ("MFO") was enacted to provide a legislative and regulatory framework for mutual funds, however the ordinance has not yet been brought into operation.

The MFO covers the following broad headings:

- types of mutual fund;
- mutual fund administration;
- Superintendent of mutual funds; and
- supervision and enforcement.

Under the MFO there will be three categories of mutual fund, namely:

- registered funds which are constituted under the laws of TCI;
- recognised funds which are constituted elsewhere and which are listed on a stock exchange as prescribed in the regulations; and
- licensed funds which do not qualify under either of the above headings.

Funds will need to supply evidence, *inter alia*, that they qualify as a particular fund type, provide particulars of the promoter, the current prospectus and the prescribed fee.

The MFO also provides for the licensing of mutual fund administrators. Within its definitions, "administration" includes, in addition to the requirement to administer the fund, the management of the fund and the control of substantially all the assets.

Two categories of licence will be permitted, full and restricted, the latter allowing the licensee to conduct administration in respect of funds specified from time to time in its licence.

Applications will be assessed by the Permanent Secretary, Finance based on fitness and probity checks consistent with those already carried out in respect of other licensed activities in the jurisdiction.

7.3.2 **Regulations and guidance notes**

Draft regulations have been produced and were circulated to the practitioners in the industry in December 1999 prior to finalisation. Comments are still being received from the industry.

No guidance notes have yet been developed.

7.3.3 **Supervision and enforcement - systems and procedures**

7.3.3.1 ***Regulatory structure***

Whilst the Governor is responsible for the overall supervision of international finance applications will be determined by the Permanent Secretary, Finance on the advice of the FSC. Day-to-day supervision will be the responsibility of the FSC.

7.3.3.2 ***Monitoring***

The MFO imposes various conditions on licence holders, the principal criteria being:

- ensure that audited annual accounts prepared in accordance with generally accepted accounting principles and sent to investors within four months of the year end in respect of each fund;
- notify the FSC within 30 days of its occurrence any changes to the information supplied with the initial application;
- ensure fund prospectuses are current and file with the FSC amended versions;
- submit its own audited annual accounts prepared in accordance with generally accepted accounting principles within such time as the FSC prescribes; and
- submit an annual return detailing a list of all funds administered (including exempted funds, that is to say, those with fewer than 15 investors) with any additions or deletions from the last return and a certificate stating compliance with the MFO and any conditions attached to the licence.

7.3.3.3 ***Ongoing supervision and enforcement***

The FSC will have responsibility for examination of the returns submitted to them annually as described above. In addition to this, the MFO provides for the power to:

- examine the books and records of any administrator;
- make requests for information;
- request an immediate audit; and

- examine the affairs of an administrator to verify compliance with the terms of its licence and ensure that it is financially sound.

The FSC can undertake an examination of the affairs of a mutual fund administrator where there are reasonable grounds to believe that the administrator has failed to fulfil certain criteria as set out in Sections 26(1) of the MFO.

The sanctions available to the FSC are as follows:

- prevent the administrator from taking on new business;
- appoint an alternative administrator;
- direct the administrator to provide additional capital; or
- direct the administrator from making specific investments.

General inspection powers are available under the MFO before any of the sanctions above would need to be used.

7.4 **Issues and recommendations**

7.4.1 **Introduction**

The enactment of legislation relating to the regulation and supervision of mutual funds in TCI is a positive step. However this development has been diminished by the failure to bring the legislation into force. Consequently, TCI fails to comply with the applicable IOSCO Principles.

7.4.2 **Mutual Funds Ordinance**

The MFO is not yet effective and consequently we cannot make an assessment of its adequacy in practice at this time. In order to progress towards meeting IOSCO principles the MFO must be introduced as soon as possible.

Unless the legal interpretation of the term 'records of the administrator' can be extended to include records of the individual funds administrated, section 21(a) of the MFO does not appear to provide power to the Superintendent to inspect individual client records. This provides a hindrance to the proper performance of on-site inspections by the Superintendent and consequently is not in compliance with IOSCO principles.

7.4.3 **Regulations**

As the regulations are still in draft form and therefore subject to change we have not conducted a full assessment. It does, however, appear that the current draft regulations exclude the following areas:

- asset valuation;
- pricing;
- sale/purchase/redemption/creation of units/shares;
- the disclosure of fees and other charges; and
- custody of client monies and assets;

As a result of this, the regulations if not amended, will not conform with IOSCO Principles 19 and 20. The final version should therefore be amended to include these matters.

Finally, any breach of the anti-money laundering legislation or regulations should also be grounds for regulatory action. We recommend that the draft regulations are amended to include this provision.

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8 Companies

8.1 Introduction

As recognised by the TOR, there are no specific international standards concerning the regulation and supervision of companies. However, there are a number of international standards concerning the operation and management of companies. These include the OECD "Principles of Corporate Governance", the G7 "Report on Transparency and Accountability" and the IMF "Guide to Progress in Strengthening the Global Financial Architecture". There is also the work of the International Accounting Standards Committee. Whilst other international standards exist, these primarily relate to particular financial services activities such as banking, securities and insurance and many of their requirements are not directly applicable to ordinary trading and holding companies.

The OECD Principles cover:

- the rights of shareholders;
- the equitable treatment of shareholders;
- the role of stakeholders in corporate governance;
- disclosure and transparency; and
- the responsibilities of the board of directors.

The Guidance Notes cover the following additional issues with regard to companies:

- the ability of law enforcement and regulatory authorities to identify quickly and efficiently the shareholders and directors of a company and the beneficial owners of a company's shares;
- the ready availability of financial information relevant to the activities of companies to law enforcement and regulatory authorities;
- requirements concerning accounting disclosure and auditing practice, particularly where there are obligations to third parties;
- the circumstances in which accounts should be produced and when accounts should be made public;
- the investigative and enforcement powers available to the OT; and
- standards of corporate governance.

The TOR and the Guidance Notes cover companies and company service providers together. However, we consider that it is useful to consider them separately, which we have done in this Report.

We consider that the regulation of company service providers is the most practical and effective way of deterring the abuse of company structures and of ensuring that relevant information is available to law enforcement and regulatory authorities. This approach is in accordance with the views expressed in the recent UK Home Office "Review of Financial Regulation in the Crown Dependencies" (Section 13.4.1). Nevertheless, there are areas where the requirements imposed upon companies themselves need to be enhanced.

In considering these enhancements, we have not undertaken a review of company or insolvency law as a whole. The TOR do not require us to do this. Instead we have assessed the legislation and regulation of companies in TCI against the international standards referred to above and the criteria in the Guidance Notes summarised above.

8.2 Type and scale of activities

There are two types of company which may be incorporated in TCI, an ordinary company and an exempted company. Both types of company are incorporated under the Companies Ordinance (Cap. 122) ("CO").

An exempted company may be registered as a limited life company ("LLC") under section 198A of the CO.

Ordinary companies are used for domestic purposes and relatively few are incorporated each year.

Exempted companies and LLCs are used as offshore vehicles.

The table below shows the numbers of companies incorporated in each of the last three years by category and the total incorporated to 31 December 1999.

Type of company	**1997**	**1998**	**1999**	**Total at 31/12/99**
Ordinary Companies	355	410	373	2,545
Exempted Companies	2,635	3,026	2,366	13,499
LLCs	90	40	36	114

No statistical information is available concerning the uses to which exempted companies and LLCs are put or concerning the main markets for the companies. However, we have been advised by the FSC that:

- exempted companies are used primarily as asset holding vehicles; and
- the main market for TCI exempted companies is North America (including Canada).

8.3 **Factual assessment**

8.3.1 **Legislation**

The CO provides for the incorporation, administration and operation of all types of companies in TCI and for ancillary matters such as financial disclosure, insolvency and winding up.

A TCI company may be:

- a company limited by shares;
- a company limited by guarantee;
- a company limited by guarantee but with a share capital;
- an unlimited company; or
- a company with both limited and unlimited liability (exempted company only).

Every TCI company must have a registered office in TCI, notice of which must be filed with the Registrar of Companies ("Registrar"). The address of the registered office of a company is a matter of public record.

The CO does not provide for the appointment of a registered agent.

The provision of registered office services is not currently a regulated activity in TCI, although it will be when the Company Management (Licensing) Ordinance is brought into force. This is covered in the section on company service providers.

Neither type of company is required to prepare audited accounts.

8.3.1.1 ***Ordinary company***

Subject to any restrictions in its memorandum of association, an ordinary company may carry out any lawful object and may therefore carry on business or hold property both within and outside TCI.

8.3.1.2 ***Exempted company***

The main differences between an exempted company and an ordinary company are as follows:

- an exempted company may not hold land in TCI or trade in TCI with any person, firm or corporation except in furtherance of its business carried on outside TCI, unless the trade is of a minor nature (section 191);
- even if incorporated as a limited liability company, an exempted company is not required to have the word "Limited" or "Ltd" in its name;
- an exempted company is not required to keep a register of members, a register of mortgages and charges or a register of directors, whether at its registered office or elsewhere;
- an exempted company is not required to file an annual list of members and return of capital, but must file an annual declaration confirming that, *inter alia*, its operations have been mainly outside TCI;
- an exempted company is not required to keep records of ordinary resolutions of members or minutes of the annual general meeting or of meetings of directors;
- an exempted company must have a representative resident in TCI authorised to accept service;
- an exempted company may not make any invitation to the public in TCI to subscribe for any of its shares or debentures; and
- an exempted company is exempt from taxes and duties for a period of 20 years from its incorporation.

There is a system for the optional registration of charges of an exempted company.

Sections 199 to 204 of the CO contain confidentiality provisions appertaining to exempted companies. These are discussed in the section on international co-operation.

8.3.1.3 ***Limited life company***

As an LLC is an exempted company, the previous paragraph also applies to LLCs.

The main features of an LLC are that:

- the life of an LLC on registration must be limited to 50 years, although it can be extended to a maximum of 150 years;
- the name of an LLC must end with "Limited Life Company" or "LLC";
- the articles of an LLC may contain certain provisions relating to controls over the transfer of shares and management of the LLC by its members;
- the voluntary winding up of an LLC is taken to have commenced on the expiration of its term or on certain other specified events; and
- an LLC will cease to be an LLC on certain specified events.

8.3.1.4 ***Foreign companies***

A body corporate incorporated outside TCI which establishes a place of business or carries on business within TCI, referred to as a "foreign company", must within one month of doing so, file with the Registrar for registration under section 208 of the CO.

8.3.2 **Regulations, rules and guidance notes**

No regulations have been issued under the CO. The Registrar has issued guidelines on company names.

8.3.3 **Supervision - systems and procedures**

8.3.3.1 ***Regulatory structure***

There are currently six persons employed in the Companies Registry. The Registrar reports to the Superintendent of the FSC.

The Registry has the benefit of a computer system which records basic company information in a database. There is no

electronic (imaged) or microfiche storage of filed documents. The Registry has commenced a project to update the companies' database which, the FSC advised us, should be completed by the end of August 2000.

The Registrar is responsible for maintaining the Register of TCI companies and for registering documents filed. Although some basic checks may be undertaken, this is essentially a recording function.

As the Registrar's role is not a regulatory one, there is little supervision of companies in TCI. The Registrar's primary supervisory responsibility is ensuring compliance with the filing requirements.

8.3.4 **Enforcement - systems and procedures**

8.3.4.1 ***Introduction***

The Registrar may impose fines for certain breaches of the CO. Otherwise, the only enforcement powers available in respect of companies are inspection, winding up and striking off.

8.3.4.2 ***Inspection***

The Attorney-General may appoint an inspector under section 61B of the CO to examine the affairs of a company if he decides that it is necessary or desirable for the detection or prevention of any crime, the maximum punishment for which exceeds 6 months imprisonment or a fine of US$1,000.

The Court may appoint an inspector to examine the affairs of the company on the application of the Attorney-General or a specified proportion of members.

8.3.4.3 ***Striking off***

Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation or where an exempted company does not file its annual return or pay its annual fee he may strike the company off the register of companies.

8.3.4.4 ***Winding up***

The Attorney-General has the power to petition for the winding up of a TCI company on the grounds that it is just and equitable for the company to be wound up.

8.3.5 **Public availability of information**

The information concerning a TCI company which is held by the Registrar includes:

- the memorandum and articles of association;
- the names and addresses of the subscribers;
- the dates of execution and filing of the memorandum of association;
- the address of the registered office;
- the directors of the company (except an exempted company); and
- the register of shareholders on the date that the return is compiled.

All of the above information is available for public inspection.

8.3.6 **Non-public information**

8.3.6.1 ***Ordinary company***

An ordinary company must maintain the following registers, books and records:

- a register of members;
- a register of mortgages and charges (limited company only);

- a register of directors and secretaries;
- minutes of all resolutions and proceedings of members and directors; and
- proper books of accounts complying with section 57 of the CO.

The above books and records, other than the register of mortgages and charges and the books of account, must be kept at the registered office of the company.

The CO does not specify where the register of charges and other books and records should be kept. There is no requirement for a written record of the location of the register of charges and the other books and records of the company to be kept at the registered office.

The register of members of an ordinary TCI company is not open to public inspection, although it is open to the members.

8.3.6.2 ***Exempted company***

An exempted company is not required to keep registers of members or directors, although it is required to keep proper books of account.

8.3.7 **Directors**

Section 18A of the CO provides that every company, including an exempted company, must have at least one director. The CO does not make provision for the role and duties of directors.

Corporate directors are permitted.

There are no provisions enabling an individual to be disqualified from being a director of a company on the grounds that he is not fit to be a director of a company.

8.3.8 **Beneficial ownership**

There is no legal requirement under the CO for the beneficial owners of shares in a TCI company to be notified to the company or to the Registrar. However, in the case of Exempted Companies, the local agent or manager is obliged by the Proceeds of Crime (Money Laundering) Regulations to know the identity of the beneficial owner.

8.3.9 **Bearer shares**

Subject to any limitations in its memorandum or articles of association, a TCI company can issue bearer shares.

There is no information available concerning the number of companies which have issued bearer shares. Nevertheless, it is believed that bearer shares are issued.

A company empowered to issue bearer shares may not hold land in TCI.

8.3.10 **Insolvency**

Part V of the CO provides for the winding up of TCI companies.

8.4 **Issues and recommendations**

8.4.1 **Introduction**

We have not undertaken a detailed review of the CO as stated in our guidance notes. Therefore, our specific comments and recommendations concerning the CO should not be taken as being the only amendments which may be required. However, we have reviewed those aspects of the legislation which bear directly on our TOR and taken an overview of the legislation for the purposes of comparing it against the OECD Principles of Corporate Governance.

From our overview it is apparent that the CO is a fairly comprehensive piece of legislation containing many of the features which we would expect to find. It is our view that the CO complies with some, but not all of the good practice standards set out in the Guidance Notes. However, given the limitations imposed upon us by the TOR, there are a number of areas which we have not reviewed. We consider that the legislation should be subject to a review which should include the insolvency provisions.

It is principally in respect of exempted companies that we consider the CO fails to comply with good practice standards. These are addressed below.

8.4.2 **Companies**

8.4.2.1 ***Publicly traded companies***

The preamble to the OECD Principles states that "The Principles focus on publicly traded companies". Similarly, we consider that the G22 Report and the IMF Guide are primarily focused on public and publicly traded companies.

We consider that where TCI companies can be publicly traded they should, under international standards, be subject to the OECD Principles, together with the G7 and IMF standards.

There are two views which can be taken of this. The first is that a stock exchange should not list a company from a jurisdiction whose companies legislation fails to meet the Principles. The second is that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework (taking the legislation and case law together) fully meets the Principles and the G7 and IMF standards.

In our opinion, although the first view is undoubtedly correct, a jurisdiction should not rely on exchanges in other jurisdictions to "police" the Principles on its behalf. In our view, good practice dictates that a jurisdiction which permits its companies to be publicly traded should ensure that its legal framework complies with international standards. We consider that the same standards should apply where the shares of a company can be offered for sale to the public, even if those shares are not publicly traded.

Furthermore, the recommendations of the G22 Working Group on transparency and accountability include a recommendation that national standards for disclosure should reflect five basic elements: timeliness, completeness, consistency, risk management and audit and control processes.

There is no distinction in the CO between public and private companies. Subject to certain controls in the CO, any company can issue shares to the public and its shares may be publicly traded.

The controls in the CO are as follows:

- the approval of the Registrar must be obtained before any prospectus is issued (section 30C);
- an exempted company is prohibited from making any invitation to the public in TCI to subscribe for any of its shares or debentures (section 193); and
- the Registrar may prohibit the sale of, or an invitation to subscribe for, shares or debentures in a foreign company or an exempted company in TCI.

In our opinion, the controls in the CO do not go far enough to meet international standards.

We recommend that the CO should be amended to create a distinction between those companies which can offer their shares to the public and those which cannot and then subject those companies to a legal framework that complies with the Principles.

8.4.2.2 ***Private companies***

The preamble to the OECD Principles states that the Principles "to the extent that they are deemed applicable might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises".

In respect of companies whose shares may not be issued to the public (which, although there is no distinction in the CO, we call "private companies") we have assessed those aspects of the Principles which it is reasonable to apply.

We consider that the following sections of the Principles should, in the most part, apply to private companies:

- rights of shareholders (section I);
- equitable treatment of shareholders (section II); and

- responsibilities of the Board (section IV).

We consider that the CO falls short of the Principles in a number of respects. For example, there are inadequate provisions concerning the protection of minority shareholder interests, potential conflicts of directors' interests and there are no insider trading or abusive self-dealing provisions.

8.4.3 **Audit**

8.4.3.1 ***Audit of accounts of public and publicly traded companies***

We consider that all public and publicly traded companies should, in line with OECD Principles, be required to prepare and submit annual audited accounts.

In the case of both public and publicly traded companies these accounts should be available to the public. There is no requirement for any company to prepare and file audited accounts in TCI. We consider that the distinction should be made and that public and publicly traded companies should be required to file accounts audited prepared in accordance with International Accounting Standards or an equivalent (eg US GAAP).

8.4.3.2 ***Audit of accounts of private companies***

We do not consider that, unless it is a regulated institution, a private company should be required to prepare and submit audited accounts as the cost and burden of such a requirement would outweigh the benefits.

We consider that it is open to the shareholders in a private company to require the accounts of the company to be audited. We consider it appropriate that the choice should be the shareholders to make. Similarly it is a matter for potential creditors and others who do business with such companies to determine whether they wish to require an audit as a condition of entering into a business relationship.

8.4.4 **Directors**

We consider that a number of steps need to be taken to facilitate compliance with the OECD Principles in this area.

The OECD Principles require the responsibilities of directors to be adequately set out. In many common law jurisdictions this is covered by common law rather than statute.

Provision should be made in legislation for the disqualification by the Court of directors who are not fit to be involved in the management of a company. This will reduce the use of so called "nominee" directors as a director can be held accountable for a failure to fulfil his duties. The concept of "nominees" director is not recognised in the legislation and therefore it is important that effective action can be taken against those who do not exercise their fiduciary duties as directors appropriately. This approach accords with that taken in the "Review of Financial Regulation in the Crown Dependencies" (Section 11.1.4).

There is currently no requirement for an exempted company to keep a register of directors or to file details of its directors with the Registrar. We cannot see the justification for this. We consider that every TCI company should be required to keep a register of directors and file details of its directors with the Registrar. This approach is in accordance with the OECD Principles of Corporate Governance, Section IV, "disclosure and transparency".

We also consider that the names of directors should form part of the publicly available information held at the Companies Registry.

There is also a need to address the issue of corporate directors. We consider that the use of corporate directors, whilst common in both on and offshore jurisdictions, could lead to a failure to comply with the OECD Principles concerning the responsibilities of the board and, in particular, the key functions of the board, such as reviewing and guiding corporate strategy.

It would however be inappropriate to impose a restriction on the use of corporate directors in the OTs until such time as the matter is addressed on a multi-jurisdictional basis. We therefore recommend that corporate directors should continue to be permitted until such time as the issue is addressed internationally. However where corporate directors are provided by a company service provider, the CSP should be required to ensure that the directors duties are being properly fulfilled. This is dealt with in the next section.

In summary, in respect of directors, we recommend:

- that exempted companies should be required to maintain a register of directors and that particulars of directors should be filed at the Companies Registry;
- those who provide directors by way of business should be required to take appropriate steps to ensure those directors are aware of their responsibilities and are suitable for the role; and
- that there should be provision in the CO for a director to be disqualified on the grounds that he is not fit to be involved in the management of a company.

8.4.5 **Beneficial ownership**

An effective way to determine beneficial ownership is through a requirement to formally disclose this to the Registrar. We recognise, however, that this approach is not always practicable. As an alternative we consider good practice is met by requiring company service providers to be licensed and to be obliged to establish and record the beneficial ownership of the companies for whom they provide the service. Our proposals in respect of this are contained in the section on company service providers.

The requirements for establishing beneficial ownership may be met by any client verification requirements which are contained in the Proceeds of Crime (Money Laundering) Regulations. This being so, there must be a link between the companies legislation and the Proceeds of Crime (Money Laundering) Regulations so that the regulator can enforce the requirements directly. For example, a breach of the Proceeds of Crime (Money Laundering) Regulations could be grounds for revocation of the licence. Recommendations in relation to this are covered in the section on company service providers.

8.4.6 **Bearer shares**

Bearer shares and share warrants to bearer can provide a significant level of anonymity, which may be abused by those seeking to use companies for a criminal purpose. Furthermore, fictitious bearer shares can be used to perpetrate fraud. There are, however, legitimate reasons for the use of bearer shares and the issue of bearer shares or share warrants to bearer is permitted in many jurisdictions, including the United Kingdom.

In the circumstances, we do not consider that good practice requires the issue of bearer shares and share warrants to bearer to be prohibited but they must be controlled effectively to prevent abuse.

In our opinion, the issue, to an end client, of bearer shares is incompatible with good practice as the tracing of beneficial ownership may become impossible.

We therefore recommend that the CO be amended to require the immobilisation of bearer shares as a condition of their issue.

8.4.7 **Company records**

As indicated, despite the requirement to keep proper books of accounts, an exempted company does not have to maintain registers of members, directors or charges or records of minutes of meetings of members and directors. We consider that this does not comply with international standards.

We consider that every company, including an exempted company, should be required to keep a register of members and a register of directors. Both registers are an essential part of the audit trail.

8.4.8 **Registered office**

We consider that every TCI company (whether ordinary or exempted) should be required to keep its registers of members and directors at the registered office. This is already a requirement in respect of ordinary companies and the requirement should be extended to exempted companies.

We also consider that, in order that the audit trail is not broken, every TCI company should be required to keep at its registered office details of the location or locations where its other books and records are kept.

8.4.9 **Company names**

We consider that a limited liability exempted company should be required to have the word "Limited" or "Ltd" or the equivalent as part of its name. Although the FSC has issued guidance to this effect, we consider that this should be given legislative effect.

8.4.10 **Insolvency**

We consider that the winding up provisions in the CO are inadequate as they do not contain features which we would expect to see in a modern piece of insolvency legislation.

8.4.11 **Enforcement powers**

We consider that the current powers of enforcement in the CO are inadequate. We recommend that the following additional enforcement powers should be created:

- the Registrar should have the power to strike an ordinary company or Limited Partnership off the Register if it fails to comply with an obligation imposed on it under the CO, eg to file its annual return;
- the Registrar should be able to apply to the Court for winding up of a company on the public interest grounds; and
- the grounds upon which the Attorney-General can appoint an Inspector should be clarified so that he or the Superintendent of the FSC should be given the express power to apply to the Court for the appointment of an inspector on the public interest ground. The power of the inspector should include the ability to obtain all relevant documents and interview anyone with relevant information, under oath.

We welcome your comments on this site.

Prepared 27 October 2000

9 Company service providers

9.1 Introduction

Company management business typically encompasses a number of activities, including:

- the formation of companies for clients;
- the provision of the registered office for companies;
- the provision of the registered agent for companies (in those jurisdictions the legislation of which provides for registered agents);
- the provision of nominee shareholders;
- the provision of director services; and
- the preparation and filing of statutory forms for companies.

In this Report we refer to those who undertake company management business as company service providers ("CSPs").

Most of the OTs have legislation which provides for the regulation of CSPs, although not necessarily covering all the above activities.

There are no international standards concerning the regulation and supervision of CSPs, a point recognised by the TOR. Indeed, it is significant that few jurisdictions, either onshore or offshore, regulate these activities. The TOR therefore require us to assess whether the legislation, framework and arrangements in place for the regulation of CSPs conform to the international and good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The principal international and good practice standards set out in the TOR and the Guidance Notes are as follows:

- those who provide company services should be licensed and subject to effective regulation;
- the regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed CSPs, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the court to wind up a CSP;
- the regulator should be able to take appropriate enforcement action, including disciplinary action, for example by revoking a CSP's licence, as well as to pursue civil and criminal sanctions;
- CSPs should have in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures;
- law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the directors of and the shareholders in a company serviced by a CSP and the beneficial owners of the shares in such a company; and
- CSPs, when providing director services, should be required to fulfil their responsibilities as directors and should not be permitted to abrogate their responsibilities through, for example, the use of general powers of attorney.

As indicated in the section on companies, the most practical and effective way of deterring the abuse of company structures and ensuring that relevant information is available to law enforcement authorities is through the regulation of CSPs. Therefore, we consider that ensuring compliance with the above international and good practice standards should be a priority for each OT.

Our assessment of the regulation of CSPs in TCI and our recommendations concerning enhancements are set out below.

9.2 **Type and scale of activity**

There are currently 35 companies based in the jurisdiction which act as CSPs. The majority of the work is carried out by local lawyers and accountants, although there are several company managers.

9.3 **Factual assessment**

9.3.1 **Legislation**

There is no legislation in force regulating the provision of company services.

The activities of company service providers will be regulated under the Company Management (Licensing) Ordinance 1999 ("CMLO"). This Ordinance has been enacted, but not yet brought into force, however a commencement date of 8 November 2000 has been set.

9.3.2 **Regulations, rules and guidance notes**

A code of conduct applicable to CSPs has been drafted and will come into effect on 8 November 2000.

No guidance has been issued in respect of CSPs.

We note that persons licensed under the CMLO are subject to the Proceeds of Crime (Money Laundering) Regulations 1999.

9.3.3 **Supervision - systems and procedures**

9.3.3.1 ***Regulatory structure***

The Permanent Secretary, Finance will be responsible for the licensing of CSPs under the CMLO.

Day-to-day supervision of licensees will be undertaken by the Superintendent of Company Managers who was appointed under the CMLO in January 2000 ("the Superintendent").

9.3.3.2 ***Licensing process***

When the CMLO comes into effect, applications for a licence will be made to the Permanent Secretary, Finance through the FSC.

We are advised that persons currently carrying on company management business will not be "grandfathered" into the CMLO. However, many of the active CSPs are already licensed and regulated by virtue of activities in other financial services sectors, for example as trustees. In these cases, the vetting process will be reduced.

The FSC advised us that persons currently carrying on company management business who are not subject to regulation under another Ordinance will be treated as new applicants.

The Permanent Secretary, Finance may not grant a licence under the CMLO unless he is satisfied that the applicant has met the following criteria:

- he is in all respects, by virtue of solvency and integrity, a fit and proper person;
- he has adequate knowledge and experience;
- he has a manager who is ordinarily resident in TCI; and
- the company cannot issue bearer shares.

We were advised by the FSC that, in respect of new applicants, checks will be carried out to verify individuals' CVs and references and that a police check will be requested from the Financial Crimes Unit.

9.3.4 **Ongoing supervision**

9.3.4.1 ***Off-site supervision***

CMLO licensees will be required to submit the following on an annual basis:

- a certificate stating that, to the best of their knowledge, they have conducted their business in accordance with the CMLO and any conditions imposed on their licence; and
- a list of companies for which they have acted, by company type and any changes from the previous annual list.

In addition, licence holders will be required to make an annual declaration of solvency.

9.3.4.2 ***On-site inspection***

The FSC will have the authority under the CMLO to carry out on-site inspections. However, it is unclear from the CMLO whether the FSC will be able to gain access to the underlying client files without a Court order.

We understand from the FSC that inspection procedures are currently being developed.

As licensing has not yet commenced, we are unable to substantiate supervisory procedures.

9.3.5 **Enforcement - systems and procedures**

All enforcement action under the CMLO will vest in the Permanent Secretary, Finance. Enforcement action will include:

- the imposition of fines;
- the revocation of a licensee's licence; and
- the imposition of directions or conditions upon a licensee.

As licensing has not yet commenced, we are unable to substantiate any enforcement procedures or powers.

9.4 **Issues and recommendations**

9.4.1 **Introduction**

We note that the CMLO is to be brought into force in November 2000. Until the legislation is in force and a licensing and supervisory scheme established, TCI will not be in compliance with the international and good practice standards set out in the Guidance Notes.

Furthermore, we consider that the CMLO requires some enhancements which are set out below.

9.4.2 **Regulatory supervision**

9.4.2.1 ***International co-operation***

The gateways for co-operating with foreign regulatory authorities in the CMLO are generally good. However, they will not be effective unless the Superintendent has access to client information. As the CMLO does not currently permit the Superintendent to obtain client information without a Court Order, we do not consider that the good practice standards set out in the Guidance Notes will be met.

9.4.2.2 ***Licensing process***

We note that the CMLO requires that the applicant is "fit and proper". However, this does not extend to shareholders, directors and managers. We consider that it should do so and recommend that the CMLO is amended accordingly.

We therefore support the proposed section in the draft Bill which places the "fit and proper" requirement on a statutory footing by amending the legislation to reflect actual practice.

9.4.3 **Code of Practice**

To facilitate the meeting of the international and good practice standards identified in the Guidance Notes, we consider that all CSPs should be subject to an enforceable code of practice or enforceable regulations. The code of practice or regulations which we recommend are issued after the CMLO has been brought into force, should include requirements relating to:

- the maintenance of the records in the jurisdiction;
- knowing the beneficial owner of a company on an ongoing basis;

- the suitability of directors provided by the licence holder;
- the mechanisms for ensuring the immobility of bearer shares;
- the provision of powers of attorney;
- the conduct of directors provided by licence holders;
- the segregation of client money and assets; and
- the provision of signing authorities to other persons, including shareholders and the beneficial owners of shares, to a bank account of a company where the licence holder provides director services.

Where areas listed above are adequately covered by the Proceeds of Crime (Money Laundering) Regulations 1999, then the Code of Practice may require adherence to those regulations provided that, to provide regulatory enforcement, a breach of the anti-money laundering regulations is treated as a breach of the Code of Practice itself.

9.4.3.1 ***Ongoing supervision***

Off-site

In accordance with good practice we consider that all CMLO licences should be required to provide the Superintendent on an annual basis with audited financial accounts.

On-site

As indicated, the CMLO restricts the ability of the Superintendent to access client files or information without a Court order.

We do not consider that the Superintendent can carry out an effective on-site inspection without access to client files to test the processes and procedures of the licensee and to ensure that the CMLO and the Code of Practice (when issued) are being complied with.

We consider that there is a need for legislative authority to enable the Superintendent to undertake on-site inspection visits and to give him the ability to review individual client files to ensure that the CMLO and code of practice are being complied with.

We therefore recommend that the CMLO should be amended to give the Superintendent routine access to client files for the purposes of an on-site examination.

We recommend that an on-site procedures manual is developed as soon as possible.

9.4.4 **Enforcement**

We consider that enforcement powers should be vested in the Superintendent.

The CMLO should be enhanced by the addition of the following enforcement powers:

- apply to the Court, where necessary, for injunctive or other reliefs to protect the clients of a licensed or formerly licensed CSP;
- the power to petition the court for the winding up of a CSP in the public interest;
- powers to "police the perimeter" by conducting investigation of persons suspected of undertaking licensable activities without authorisation; and
- the power to appoint a manager to take over the running of a CMLO licensee.

9.4.5 **Insurance**

No guidelines have been issued as to the circumstance in which CSPs should effect insurance cover.

We accept that the cost of professional indemnity and other insurances is high and may be an unnecessary burden in some cases. Nevertheless, we consider that there is a strong argument for requiring every CSP to effect professional indemnity

insurance cover and for requiring any CSP who has control over client funds to effect fidelity insurance.

However, without a greater knowledge of the business undertaken by CSPs in TCI, we do not consider that it would be appropriate for us to make specific recommendations as to the circumstances in which CSPs should be required to effect insurance cover nor as to the types and minimum amounts of such cover.

We recommend that the Superintendent should, perhaps after taking specialist insurance advice, prepare guidelines setting out in detail the circumstances in which licensed CSPs are required to effect insurance, the type of insurance to be effected and the minimum amounts of cover required. We consider that it is appropriate for the Superintendent, in preparing these guidelines, to assess whether the cost of insurance is proportional to the benefits in client protection that it would bring.

Finally, a licensee who is required to effect insurance cover should be required to satisfy the Superintendent that the appropriate policies are in place on an annual basis.

9.4.6 **Bearer shares**

The issue of bearer shares to end clients without any control being exercised is contrary to good practice as it is difficult, if not impossible, to ascertain the beneficial owner of the company at any given time.

Where a company is incorporated and the company manager does not provide director services, the directors can issue bearer shares without the knowledge of the company manager.

Whilst we are not persuaded that international practice and standards require the outright prohibition of bearer shares, we consider that their use must be strictly controlled. We therefore consider that the Companies Ordinance should be modified to require that bearer shares may only be issued if they are immobilised.

The immobilised share must either be retained by the licence holder or by someone acting on his authority. The details of the requirement should be contained in the Code of Practice.

If this cannot be achieved, consideration should be given to prohibiting the use of bearer shares.

We welcome your comments on this site.

Prepared 27 October 2000

10 Partnerships

10.1 Introduction

The legislation in all of the OTs provides for two different types of partnership, ordinary or general partnerships and limited partnerships. None of the OTs have legislation in place that provides for the formation of limited liability partnerships (i.e. partnerships which are separate legal entities where, unlike limited partnerships, the limited partners are permitted to take part in the management of the business which and are primarily used as vehicles for professional firms).

10.1.1.1 *Ordinary partnerships*

The ordinary partnership legislation of those OTs that have it is based upon the UK Partnership Act. Neither the UK Partnership Act nor the OT partnership legislation establishes supervisory regimes. The legislation typically sets out the rules for determining the existence of a partnership and governs, to a limited extent, the relationship between partners and between the partnership and third parties. Ordinary partnerships are not subject to registration in any of the OTs. The liability of all partners in an ordinary partnerships is unlimited.

Ordinary partnerships are formed almost exclusively by domestic businesses in the OTs usually where the business is small or where the members of a particular profession are prohibited from carrying on business through a limited liability company.

As ordinary partnerships are not generally used for offshore purposes we do not consider that they fall within our TOR and we have not covered them in our review. Insofar as ordinary partnerships, such as lawyers and accountants, also act as company or trust service providers their role is dealt with in those sections of this Report.

10.1.2 Limited partnerships

Limited partnerships enable the liabilities of "sleeping partners" to be limited to their capital contribution provided that they do not take part in the management of the partnership. They are used typically in investment schemes to limit the liability of investors without giving them ownership of a share in a company. They are also used in estate planning schemes.

The TOR and the Guidance Notes require us to determine whether the legislation, framework and systems in place in each OT conform to good practice having regard, in particular, to FATF and CFATF Recommendations, the OECD Principles of Corporate Governance ("the OECD Principles") and the G22 Report on Transparency and Accountability.

There are no international standards that relate specifically to the supervision of limited partnerships. We have therefore considered the appropriateness of the above general standards for limited partnerships. It is our view that:

- the FATF and CFATF Recommendations that are of primary relevance to limited partnerships are those that concern "know your customer" and record keeping procedures;
- the OECD Principles are designed primarily for publicly traded corporations and are not appropriate to limited partnerships; and
- the G22 Report on Transparency and Accountability is not applicable to limited partnerships.

Due to the limited liability given to limited partners, limited partnerships are attractive offshore vehicles and, in common with all offshore vehicles, are subject to potential abuse by money launderers and other criminals. We therefore consider that good practice requires that, in the event that a limited partnership is suspected of being involved in criminal activity, the law enforcement authorities should be able to access information concerning both the limited and general partners. This approach was envisaged by the Guidance Notes.

We also consider that the business of:

- forming limited partnerships;

- providing a registered office for limited partnerships; and
- acting as a registered agent

should be regarded as financial services. As such, it is important that high standards are maintained for the protection of clients. Subject to special circumstances, we consider that good practice standards require that these activities should be regulated.

10.2 **Type and scale of activity**

There are two types of partnership provided for under TCI law, ordinary partnerships and limited partnerships. Ordinary partnerships are governed by common law.

A limited partnership may be an exempted limited partnership.

As at 31 May 2000 there were 57 limited partnerships registered in TCI.

No statistics are kept on the type of business carried on by limited partnerships in TCI. The objects and purposes of the partnership are usually expressed in very general terms in the statement filed and any statistics compiled would therefore not be of much value.

10.3 **Factual assessment**

10.3.1 **Legislation**

The TCI has one piece of legislation concerning partnerships which is the Limited Partnership Ordinance (cap. 126) ("LPO").

The LPO permits the formation of limited partnerships and their registration by the Registrar of Companies ("the Registrar"). Limited partnerships consist of one or more general partners and one or more limited partners.

The general partners carry on the business of the partnership and have the same liabilities and responsibilities as partners in an ordinary partnership. Limited partners contribute or undertake to contribute capital to the partnership and their liability is limited to the capital that they have contributed or undertaken to contribute. To the extent that a limited partner participates in the control of a limited partnership, he is liable as a general partner to persons who transact business with the limited partnership reasonably believing that he is a general partner.

A limited partnership may be registered as an exempt limited partnership if it files a declaration that it will not undertake any business with any person resident in TCI.

An exempt limited partnership:

- must pay an annual fee and file an annual declaration of compliance; and
- may obtain from the Governor a fifty year exemption from any tax on any profits or gains that may be levied in TCI.

A limited partnership must have a registered office in TCI but it is not required to have a registered agent.

10.3.2 **Regulations, rules and guidance notes**

The Limited Partnership Rules, 1993 have been made under section 17 of the LPO.

No guidance notes have been issued concerning partnerships.

10.3.3 **The formation and registration of limited partnerships**

Persons who carry on the business of forming limited partnerships or providing the registered office for limited partnerships are not, in that capacity, currently regulated and are not subject to the proposed Proceeds of Crime (Money Laundering) Regulations 1999.

Limited partnerships must be registered with the Registrar of Companies. Registration involves filing a statement with the Registrar signed by or on behalf of the general partner and containing basic information concerning the partnership and its

partners.

No limited partner has the benefit of limited liability until the limited partnership has been registered by the Registrar.

10.3.4 **Supervision - systems and procedures**

10.3.4.1 ***Regulatory structure***

Details of the structure and resources of the Companies Registry are provided in the Companies section of this Report.

10.3.4.2 ***On-going supervision***

In common with other jurisdictions, there is no on-going supervision of limited partnerships.

10.3.5 **Enforcement - systems and procedures**

There are no specific enforcement procedures available in respect of limited partnerships, although certain breaches of the LPO are offences that are punishable by a fine.

10.3.6 **Publicly available information**

10.3.6.1 ***Information held by the Registrar***

The information contained in the register of limited partnerships maintained by the Registrar covers the following:

- the general nature of the firms' business;
- the address of the registered office of the limited partnership in TCI;
- the names and addresses of the general partners; and
- the term, if any, of the limited partnership.

A limited partnership is required to inform to the Registrar of changes in any of the above details.

An exempt limited partnership is also required to file an annual return with the Registrar.

The registers of limited partnerships, in which each memorandum is registered, is open to public inspection.

10.3.6.2 ***Information held at the registered office***

The general partners of a limited partnership must keep a register containing:

- the name and address of each individual partner;
- the amount and dates of contributions of each limited partner; and
- the amount and date of any payment representing a return of any part of a limited partner's contribution

at the registered office of the partnership.

The register of limited partnership interests is open to public inspection.

10.3.7 **Non-public information**

There are no requirements that a limited partnership keep any accounting or any other books or records.

10.4 **Issues and recommendations**

10.4.1 **Introduction**

In accordance with our interpretation of our TOR, we are required to assess whether:

- in the event that a limited partnership is used or suspected of being used for criminal purposes, the law enforcement authorities in TCI are able to obtain basic information concerning the partnership, such as the identity of the general

and limited partners;

- the identity of general and limited partners of limited partnerships in TCI has been ascertained through the usual "know your customer" procedures; and
- adequate procedures are in place to protect the interests of partnerships utilising professional service providers in TCI.

For the reasons set out in the following paragraphs we are of the view that in some respects TCI meets the good practice standards set out in the Guidance Notes.

Our recommendations follow.

10.4.1.1 ***Availability of information to law enforcement authorities***

The information required to be filed with the Registrar is set out below. This includes basic information, but it does not include details of the limited partners and their capital contributions.

The information filed is available to the public and therefore readily accessible to the law enforcement authorities in TCI.

We do not consider that good practice requires that information concerning the limited partners and their capital contributions should be filed at the Registry provided that the information is available in TCI.

The LPO requires the general partners to keep a register of limited partnership interests containing the above information which is available for public inspection.

We are therefore of the opinion that the legislative requirements prescribing the information and records to be kept in TCI meet good practice standards. Of course the quality of the information will be dependent upon:

- the due diligence checks undertaken with regard to partners; and
- the degree of compliance with regard to the other record keeping requirements.

These matters are addressed in the following paragraphs.

10.4.1.2 ***Application of know your customer and record keeping requirements***

In order to comply with FATF and CFATF Recommendations, we consider that persons who provide the service of forming limited partnerships and those who provide the registered office for limited partnerships should be subject to the usual know your customer and record keeping requirements.

This is not currently the case and TCI does not therefore comply with good practice standards.

We therefore recommend that the Proceeds of Crime (Money Laundering) Regulations are amended to cover any person who, as part of his business:

- forms limited partnerships; or
- provides the registered office of limited partnerships.

10.4.1.3 ***Regulation of professional service providers***

We are of the opinion that persons who form limited partnerships or provide registered office services for limited partnerships should be considered as financial service providers and subject to regulation. The objectives of regulation are as follows:

- the maintenance of standards through regulation that will protect partnerships using the service providers; and
- the maintenance of high record keeping standards so that records required to be kept at the registered office are maintained in good form so that they are of value to the law enforcement agencies, if required.

We therefore recommend that only licensed company managers or trustees are permitted to:

- provide registered office services; or
- form limited partnerships.

Some jurisdictions provide for the appointment of a registered agent. We consider that this is desirable and recommend that limited partnerships should be required to appoint a registered agent.

Registered agents should be licensed company managers or trustees and should be subject to the Proceeds of Crime (Money Laundering) Regulations.

10.4.1.4 ***Other areas for improvement***

The regulator currently has no enforcement powers with respect to limited partnerships. We consider that this does not comply with good practice standards.

We consider that the regulator should be able to apply to the Court for the dissolution of a limited partnership and for the appointment of an inspector in appropriate circumstances. These circumstances should include fraud, insolvency or other reasons of public interest.

We suggest that the procedure for the appointment of an inspector is established in a way that is analogous to the appointment of an inspector under the Companies Ordinance.

Finally, we recommend that it should be an offence to provide the registered office of a limited partnership by way of business when not holding a licence.

There is no requirement that a limited partnership maintain accounting records. We consider that there should be. We recommend that all limited partnerships should, as a minimum, be required to maintain such accounting records as the partners consider necessary or desirable to reflect the position of the partnership.

We do not consider that these records need to be kept within the jurisdiction provided that there is a written record of the location where the records are kept at the registered office of the limited partnership. This will ensure that in the event of a criminal investigation the audit trail is not broken.

We welcome your comments on this site.

Prepared 27 October 2000

11 Trusts

11.1 Introduction

Trusts are commonly used in offshore structures. They typically involve settlors, trustees and beneficiaries and often involve protectors, enforcers and custodians.

The settlor of a trust [2] is the person who transfers ownership of his 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.

The trustees of a trust hold legal title to the trust property. They must keep trust property separate from their own property. 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 invite and dispose of them in accordance with the settlor's trust deed, taking account of any letter of wishes.

All trusts (other than purpose trusts) must have beneficiaries who may include the settlor. The trustees must account to the beneficiaries for what they do with the trust property. The beneficiaries are entitled to enforce implementation of the trust deed. A trust may be settled without existing beneficiaries provided that a beneficiary is or beneficiaries are ultimately ascertainable.

A trust may have a protector who will typically have powers to veto the trustees' proposals or remove them. A purpose trust is a trust for a particular purpose or purposes. Most of the OTs permit charitable and non-charitable purpose trusts.

An enforcer is the person who has the power to enforce a purpose trust.

A custodian trustee holds the trust property to the order of the managing trustee.

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the TOR. The TOR therefore require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for the criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries and protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary, because a proper consideration of the above issues involve both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the "Review of Financial Regulation in the Crown Dependencies" (Section 12.9.5). Our recommendations concerning professional trust providers in

TCI are contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of TCI are required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not, in this Report, concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

11.2 **Type and scale of activity**

There are no requirements for trusts to be registered or reported in TCI. There are consequently no definitive statistics available concerning the type and scale of trust business in TCI. However, from a survey conducted by the Financial Services Commissioner on a recent round of visits to licensed trustees, the FSC believes that, as at 11 March 2000, 1,057 trusts were being administered in TCI holding assets worth approximately US$581 million.

The trust service providers consider that their main market is North America, including Canada, and that the trust business is predominantly personal, not corporate.

11.3 **Factual assessment**

11.3.1 **Legislation**

The principal legislation relating to trusts in TCI is the Trusts Ordinance (Cap. 124).

A Voluntary Dispositions Ordinance has also been enacted but has not yet been brought into force.

11.3.1.1 ***The Trusts Ordinance ("TO")***

The TO makes general provision for trusts and provides for the powers and duties of trustees and the types of trust that are permitted or facilitated.

The TO distinguishes between a "Turks and Caicos trust" and a "foreign trust". A foreign trust is one that is governed by a foreign law. A foreign trust is enforceable in TCI.

Section 13(2) provides that no Turks and Caicos trust is void or liable to be set aside on the grounds that the trust avoids or defeats any rights conferred by a foreign law upon a person by reason of a personal relationship or by way of heirship rights. This section therefore facilitates the creation of "forced heirship" trusts which are commonly utilised by settlors from jurisdictions (usually civil law jurisdictions) where the law requires assets in a deceased's estate to be distributed in accordance with a particular formula. By settling his assets into a forced heirship trust, a settlor attempts to leave his assets according to his or her wishes rather than in accordance with the formula stipulated by the law of his jurisdiction.

A number of other jurisdictions have similar legislation facilitating the creation of forced heirship trusts.

Section 3 of the TO permits purpose trusts, which are not for the benefit of the trustee only. However, section 12(2) provides that a trust is invalid to the extent that it is created for a non-charitable purpose in relation to which there is no beneficiary.

Our understanding, therefore, is that a Turks and Caicos purpose trust may not be a pure non-charitable purpose trust. A foreign non-charitable purpose trust may, however, be enforced in TCI.

Section 61(1) of the TO enables the establishment of asset protection trusts. In summary, if an individual settlor makes a disposition of property into a Turks and Caicos trust, the disposition is not voidable at the instance of a creditor of the settlor if:

- the settlor is not insolvent when the disposition was made; and
- the settlor does not become insolvent by reason of the disposition.

The Trusts Ordinance does not disapply the Statute of Elizabeth (concerning the setting aside of fraudulent conveyances) which still applies to TCI.

A Turks and Caicos trust will not be void or set aside because a foreign jurisdiction prohibits or does not recognise the concept of a foreign trust (section 13(2)).

11.3.1.2 ***The Voluntary Dispositions Ordinance ("VDO")***

As stated, the VDO has been enacted but it has not yet been brought into force.

The VDO establishes a solvency based test for setting aside dispositions of property into trust. Other jurisdictions have instead established a motive based test. The VDO disapplies the Statute of Elizabeth for those dispositions which can be challenged under the VDO.

We have been advised that there have been proposals for the VDO to be amended so as to repeal the Statute of Elizabeth. The effect of this will be to prevent the setting aside of fraudulent dispositions, providing that the solvency test is satisfied. This is discussed further under "Issues and recommendations" below.

The VDO also repeals section 61 of the Trusts Ordinance.

11.3.2 **Regulations, rules and guidance**

There are no relevant rules, regulations or guidance relating to trusts.

11.3.3 **Supervision - systems and procedures**

Trusts are not registrable in TCI and, in common with other jurisdictions, trusts are not subject to regulation by a regulatory authority. There is, therefore, no requirement for trustees, beneficiaries, custodians or protectors of TCI trusts to be notified to any central authority

Trustees do, however, have a number of duties imposed on them under the TO and duties imposed on a trustee under English common law would almost certainly be imposed on trustees by the courts in TCI.

11.4 **Issues and recommendations**

11.4.1 **Introduction**

Trust legislation in TCI is similar to the trust legislation in a number of other jurisdictions. In general, we do not consider that there are any features of the TO that are likely to lead to trust structures in TCI being considered particularly attractive to those wishing to engage in criminal conduct.

In many respects the existing trust legislation in TCI meets the good practice standards set out in the Guidance Notes. However, we recommend some changes to the TO and are concerned with the VDO to the extent that it does not meet good practice standards.

11.4.2 **Preventing the abuse of trusts**

As indicated in the introduction to this section, we consider that the most practical and effective way to prevent the abuse of trusts is through the regulation of trust service providers. We consider that all persons providing trust services for profit should be regulated. Our recommendations concerning this are set out in the next section. We do not consider that any changes to the TO are required to support this.

We are concerned, however, that the use of purpose trusts may be open to abuse. Purpose trusts have no beneficiaries to take action against trustees who are in breach of their duties and there is therefore a possibility of abuse by the trustees.

We note that pure non-charitable purpose trusts are not permitted under the TO. The meaning of "charitable" is not, however, defined in the legislation. There is no mechanism in the TO for ensuring that a charitable purpose trust is enforced, for example through the appointment of a protector. We consider that this is a weakness, especially given that the extent of charitable trusts is not clear.

We recommend that the TO should be amended so that charitable purpose trusts are clearly defined.

11.4.3 **Establishing the true owner of trust assets**

In general, beneficial ownership of assets held in an express trust may be clear and ascertainable. However, this may not necessarily be the case for a discretionary or purpose trust or where the trustees may exercise discretionary powers.

We consider that, in the case of trusts administered by a professional trust service provider, law enforcement and regulatory

authorities must, in appropriate circumstances, be able to identify the settlor, trustees, beneficiaries, protector and custodian and have access to the trust instrument and other relevant documentation concerning the trust.

This requires that the relevant documentation and information is kept within the jurisdiction. In respect of trust service providers, this is covered in the next section. This is not a general trust issue and we do not, therefore, consider that the TO requires any amendment in this respect.

11.4.4 **Anti-money laundering measures**

In our opinion, international standards require that professional trust service providers should be required to put in place effective anti-money laundering measures, including "know your customer", record keeping and staff training procedures.

Our recommendations concerning this are in the sections on money laundering and trust service providers.

We do not consider that it is appropriate to deal with this matter in the TO as the TO is not supervisory in nature.

11.4.5 **Transparency of financial arrangements**

The Guidance Notes indicate:

- that basic financial information relevant to the activities of trusts should be available to law enforcement and regulatory authorities; and
- that trustees should, ideally, be held accountable to beneficiaries by preparing regular accounts, where appropriate, which might also be available to the settlor and protector, where applicable.

We are further asked to consider in what circumstances it would be appropriate for accounts to be produced, whether accounts should be made public, in which circumstances abbreviated accounts might be acceptable and in which circumstances the requirement to produce accounts should not be applied.

We consider that professional trust service providers should be required to maintain proper financial records and that these should be available for inspection by the protector and (where appropriate) beneficiaries. We also consider that these records should be available to law enforcement authorities where required in a criminal investigation. Our recommendations concerning this are contained in the next section of this Report.

However, we do not consider that trust accounts should be made public as they are private arrangements. Furthermore, we consider that requiring the preparation of accounts and their subsequent audit may be regarded by some clients as an unnecessary cost burden. In our view it should be for the client to determine whether he wishes accounts to be prepared and audited. It is not the role of legislation to impose it. Nevertheless we believe that the preparation and where appropriate, auditing of trust accounts, is of benefit as it reduces the risk of misappropriation of trust assets.

11.4.6 **Removal of impediments to asset tracing and seizure**

This is considered further in the section on Money Laundering.

There is nothing in the legislation to prevent a "flee" clause being included in a trust deed, the effect of which may be to frustrate the seizure of assets emanating from a criminal source.

We therefore recommend that as flee clauses are an issue of general application, trust legislation should be amended to restrict their use.

11.4.7 **Asset or creditor protection trusts**

As discussed, the VDO provisions are unusual in that the test for setting aside a disposition is solvency based rather than motive based. Currently, however, as the Statute of Elizabeth is still applicable in TCI, fraudulent dispositions will be caught by it.

However, if the VDO, is brought into effect in an amended form which repeals the Statute of Elizabeth, the result will be that, provided the settlor was solvent at the time of a disposition and did not become insolvent as a result of the disposition, it will not be possible for a creditor to set the disposition aside, regardless of the motive of the settlor.

We consider this to be unsatisfactory. For example, under the VDO it will be possible for a settlor to settle the bulk of his

assets into an asset protection trust knowing that a further disposition was planned which would cause him to become insolvent although not in respect of an actual or contingent liability existing at the date of the disposition. In these circumstances his creditors will not be able to attack the first disposition.

If there is to be no motive test, we consider it essential that there should be a reasonable period of time within which, if the settlor becomes insolvent, his creditors can attack the disposition. This would provide equivalence to the UK Insolvency Act provisions concerning voidable transactions.

We are also concerned how the VDO is to apply retroactively.

We therefore recommend that the VDO is reviewed before being brought into force and that, if a solvency based test is to be used, creditors should be able to challenge the validity of a disposition if made within a reasonable period of time prior to the settlor becoming insolvent. We consider that a period of six years would be reasonable.

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2 The descriptions of settlors, trustees, beneficiaries, protectors, enforcers and custodians are based on those set out in the "Review of Financial Regulation in the Crown Dependencies" which we consider provide excellent summaries. Back

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We welcome your comments on this site.

Prepared 27 October 2000

12 Trust service providers

12.1 Introduction

There are no international standards concerning the regulation and supervision of trusts and trustees, a point recognised by the TOR. The TOR therefore require us to assess whether the trust sectors in the OTs conform to the good practice standards outlined in the Guidance Notes in respect of "Companies and Trusts".

The TOR do not require us to undertake a full review of trust law in the OTs. Instead we are required to focus on the potential for the criminal abuse of trust vehicles and the ability of law enforcement authorities to obtain information relevant to criminal investigations.

The Guidance Notes cover the following specific issues with regard to trusts:

- the prevention of the use of trusts to obscure the true ownership of assets;
- the ability of law enforcement and regulatory authorities to ascertain, quickly and efficiently, the true owners of assets held in trust for the purposes of a criminal investigation;
- the ability of law enforcement authorities to identify the settlor, beneficiaries and protector and custodian (where applicable) of a trust and to obtain a copy of the trust instrument for the purposes of a criminal investigation; and
- the availability of financial information relevant to the activities of trusts to law enforcement and regulatory authorities.

The Guidance Notes cover trusts and trust service providers together. This is necessary, because a proper consideration of the above issues involve both. However, we consider that it is useful to consider them separately in our Report.

We have focused on the regulation of professional trust service providers as we consider that this is the most practical and effective way of preventing the abuse of trust structures and of ensuring that relevant information is available to law enforcement authorities, when required. This approach is in accordance with the views expressed in the "Review of Financial Regulation in the Crown Dependencies" (section 12.9.5). Our recommendations concerning professional trust providers in TCI are contained in the next section of this Report.

In this section of the Report we consider whether changes to the general trust law of TCI are required to support the effective regulation of trust service providers.

As agreed with the Steering Committee, we are not, in this Report, concerned with private trusts in respect of which there is no ongoing involvement of a professional trust service provider.

12.2 Type and scale of activity

All "professional trustees", whether corporate or individual may be required to be licensed under the Trustees Licensing Ordinance ("TLO"). However, as discussed below, subject to certain exemptions, only trust companies are currently subject to the Ordinance.

As at 1 March 2000, there were 23 licensed trustees in the following categories:

Full licence 18

Restricted licence 5

The FSC advises that 14 of the full licence holders are local trust companies three of which are associated with TCI law firms. Of the remaining four trustees, two belong to groups headquartered outside TCI and two are owned by banks.

There is no information on the amount of unregulated trust business being carried on in TCI by non-corporate professional

trustees and by trust companies that are exempted from the TLO.

12.3 Factual assessment

12.3.1 Legislation

The only legislation governing the regulation of trust business in TCI is the TLO. A Bill amending the TLO is currently before the legislature.

The TLO provides for the licensing and regulation of trustees entitled to receive remuneration for acting as a trustee ("professional trustees"). Section 10 provides that the following must be licensed when acting as a professional trustee:

- a trust company, unless exempted under an exemption order; and
- a person specified in an extension order.

12.3.2 Application of TLO to trust companies

One exemption order had been made which exempts a trust company from the licensing requirements of the TLO if:

- it is the trustee of a single trust only and: (a) its entire issued share capital is owned by the settlor and/or one or more beneficiaries; or (b) the registered office or principal place of business of the trust company is in a jurisdiction other than TCI which adequately regulates trust companies; or
- the trust company acts as a bare trustee only.

12.3.3 Application of TLO to other professional trustees

No extension order had been made and the TLO does not therefore apply to non-corporate professional trustees.

12.3.4 Classes of trust licence

There are two classes of licence:

- a restricted trustee licence, which is issued on the basis of an undertaking by the trustee that it will act as professional trustee only in respect of named settlors; and
- an unrestricted trustee licence, which is issued without any restrictions.

12.3.5 Other provisions

Areas covered by the TLO include:

- granting and revocation of trustee licences;
- control of changes in ownership of shares in a trust company;
- control of appointment of directors and the resident manager of trust companies;
- appointment of a Superintendent of Trustees ("the Superintendent");
- duties of licensees;
- ongoing supervision of licensees;
- enforcement powers; and
- confidentiality and regulatory gateways.

Section 8 of the TLO provides that any information acquired by the Permanent Secretary, Finance or the Superintendent that relates to an application under the Ordinance, or to the affairs of a trustee, or the client of a trustee, must not be disclosed to any other person unless under the Order of TCI Court, as permitted by other legislation or in accordance with the regulatory gateway.

12.3.6 **Proposed legislation**

The Trustees Licensing (Amendment) Bill is currently before the Legislative Council. The provisions of this Bill include:

- the imposition of penalties for late submission of annual accounts, the penalties escalating in stages from a fine to revocation of the licence; and
- providing the Permanent Secretary, Finance with further enforcement or intervention powers in circumstances when the licence could be revoked, including the making of an order that a licensed trustee must not take on new business or, an order that a licensed trustee appoint an interim manager.

We note that the Bill, as drafted, gives the licensee seven days to appoint an interim manager in default of which the interim manager may be appointed by the Permanent Secretary, Finance. We consider that there may be exceptional cases of urgency in which the Permanent Secretary, Finance would wish to appoint an interim manager with immediate effect.

12.3.7 **Rules and Regulations**

The only regulations which have been issued under the TLO are the Trustees Licensing Regulations. The provisions include categories of licence, application procedures and forms, returns, accounts, directions that may be given by the Permanent Secretary Finance, the professional indemnity insurance to be effected by licensees and the issuance of guidelines by the Superintendent.

12.3.8 **Guidance**

The FSC issued two guidance notes during 1999 covering:

- related party loans; and
- ordinary company status.

The first of these, issued on 1 April 1999, sets out the Superintendent's position regarding the effect of such loans on the capital of licensed trustees. We understand that the approach outlined has been adopted in the licence renewals with effect from 1 March 2000.

The second guidance note, issued on 1 December 1999, states that it is an expectation of the FSC that trustees holding an unrestricted licence should be incorporated as an ordinary company in the jurisdiction to ensure that the owners, controllers and directors of the trustee are a matter of public record.

In addition to the above, the Association of Licensed Trustees has drafted but not yet published a voluntary code of conduct for its members. This covers *inter alia*:

- due diligence;
- custody of assets;
- annual reviews of individual trusts;
- transfer of clients;
- liability of directors; and
- maintenance of records.

No assessment of this document has been undertaken on the basis that it is neither compulsory nor in the public domain.

The Proceeds of Crime (Money Laundering) Regulations 1999 and the anti-money laundering Guidance Notes issued by the FSC also apply to professional trustees.

12.3.9 **Supervision - systems and procedures**

12.3.9.1 ***Regulatory resources***

The licensing authority for the licensing of professional trustees is the Permanent Secretary, Finance.

Day-to-day supervision of licensees is undertaken by the Superintendent, although many of the enforcement powers are vested in the Permanent Secretary, Finance.

The post of Superintendent is currently held by the overall Superintendent of the FSC on the basis that this does represent a full-time role. The Superintendent has minimal support staff.

12.3.9.2 ***Application process***

Application for a trustee licence is made to the Permanent Secretary, Finance via the FSC. The Trustees (Licensing) Regulations 1992 set out both the information and documentation to be provided and the form of the application. The Superintendent reviews the application and passes it to the Permanent Secretary, Finance with his recommendation.

Before granting a licence, the Permanent Secretary, Finance must be satisfied that:

- the applicant is "fit and proper" and capable of complying with the TLO and any terms or conditions of the licence;
- in the case of a trust company, it has a manager resident in TCI with adequate knowledge and experience of the work of corporate trustees and that the Articles of the company do not permit it to issue bearer shares; and
- it is in the public interest to issue a licence.

There is no specific requirement in the TLO or the Regulations that a trust company has a specified issued and paid up share capital. However, we understand from the FSC that in practice, a minimum share capital or an enforceable guarantee issued by the parent company, of US$ 250,000, is required.

There is no specific fit and proper test under the TLO for directors and/or controllers of trust companies. However, we are advised by the FSC that they undertake police clearance checks on directors and major shareholders.

This requirement should also include that all licence holders are subject to "four eyes" control.

Applicants for a licence are required to include information and documentation including the applicant, its managers, auditor, directors (in the case of a trust company), evidence of appropriate trust business experience. Character references are required for individual applicants, partners of partnership applicants and directors and officers in the case of corporate applicants.

A business plan must be submitted, together with full financial disclosure and business references on the principals and management of the proposed licensee.

12.3.9.3 ***Ongoing supervision***

Every licensee is required to file annual statutory returns which must include:

- the audited accounts; and
- a statement by the auditors of compliance with the trust company's business plan.

It should be noted that a copy of the auditors' management letter is not currently supplied to the regulator although it is accepted that these form an integral part of the audit process and findings.

The FSC has also recently instituted a programme of visits during which statistical information on the licensees trust business is gathered and discussions are held with trustees on:

- the maintenance of professional indemnity insurance;
- details of directors and shareholders; and
- the relevance and updating of the business plan.

These visits are not intended to constitute on-site inspections.

12.3.10 **Enforcement - systems and procedures**

If a licensee fails to comply with a term of his licence, fails to pay a fee, is convicted of an offence under the TLO, has failed

to comply with any requirement under the TLO, becomes or is likely to become insolvent, is acting or has acted in breach of trust or contrary to the public interest, is no longer a fit and proper person to hold a licence or, in the case of a company, no longer has a qualifying manager, the Permanent Secretary, Finance may revoke the licence in accordance with the procedure set out in the Ordinance.

There is no power for the Permanent Secretary, Finance or the Superintendent to apply to the courts for the winding up of a licence holder in the public interest.

The proposed changes do not include the power to suspend a licence. This power was deliberately rejected in favour of the measure outlined in 12.3.6 above.

12.4 **Issues and recommendations**

12.4.1 **Introduction**

The TCI substantially meets the requirements of Trust Service Providers as set out in the Guidance Notes. There are, however, some improvements which need to be achieved to bring regulation of Trust Service Providers in line with the Guidance Notes.

We recommend minor enhancements to the TLO and the extension of its scope to include individuals and partnerships who provide trust services. Furthermore, the Superintendent should be granted access to client files in order to effectively conduct on-site supervision. These issues are set out below.

12.4.2 **Individuals and partnerships**

The terms of reference state that those who provide trust services should be licensed and subject to effective regulation. As indicated, although the TLO enables the making of an extension order to cover non-corporate trustees, no such order has been made to date. As a result, individuals and partnerships are currently excluded from the TLO and are therefore completely unregulated.

We can see no justification for excluding individuals and partnership from regulation as trust service providers and would recommend that the TLO be amended to extend its scope or an appropriate extension order be made.

12.4.3 **Exemption orders**

The TLO enables the Governor to make an exemption order exempting specific companies and classes of company from the TLO. We consider that, if exemptions are made, it would be better for them to be provided in legislation, not in an Order.

However, more importantly, we consider as classes of company are automatically exempted from the TLO, the Superintendent is unable to assess the amount of unregulated trust business being conducted from TCI. We further consider that if classes of trust companies subject to the TLO are to be exempted, they should be required to apply for an exemption in appropriate cases. It may also be advisable to impose a reporting requirement on such trustees. This would enable the Superintendent to gain a better understanding of the trust industry in TCI.

12.4.4 **Restricted trust licences**

We do not consider that the definition of a "restricted licence" in the Regulations is adequate. A restricted licence is a licence subject to the condition that the licensee only acts on behalf of named settlors. There is no indication as to the maximum number of settlors that he may act for. Consideration should also be given to whether there should be a limit on the number or value of the underlying trusts.

As an alternative, the Superintendent could issue guidelines setting out his understanding of the limits of a restricted trust licence, but it would be preferable to set this out in the Regulations.

12.4.5 **Regulatory supervision**

12.4.5.1 ***Application process***

We consider that the TLO makes inadequate provision with regard to the application process. The conditions that the TLO requires an applicant to meet are that:

- the applicant is "fit and proper" and capable of complying with the TLO and any terms or conditions of the licence;

and

- in the case of a trust company, it has a manager resident in TCI with adequate knowledge and experience of the work of corporate trustees and that the Articles of the company do not permit it to issue bearer shares.

We note, for example, that there is no requirement that the major shareholders, beneficial owners, directors and managers meet the "fit and proper" criteria. The requirement for managers to have "adequate knowledge and experience" does not go far enough.

There is no evidence that the Superintendent is not applying fit and proper criteria, but in our view the legislation should provide him with express legal authority for this.

There should also be a requirement that at least two people are involved in the operation of a licence holder ("four eyes" control) so providing support and oversight.

As indicated, there is no minimum capital requirement, although either a minimum capital requirement or a guarantee is referred to in the specimen application form and routinely required. We consider that the current practice should be given statutory authority.

We recommend that the Superintendent prepares a procedures manual for assessing applications. This will cover the assessment of the application generally and such matters as the assessment of the business plan and the assessment and verification of references.

12.4.5.2 ***Off-site supervision***

Compliance with the filing requirements is very poor at present. This should improve when the Bill is enacted, given the enhanced enforcement powers.

12.4.5.3 ***On-site supervision***

Although the Superintendent has commenced a programme of visits, these are not intended to be full on-site inspections. We consider that an on-site inspection programme in respect of licensed trustees should be commenced as soon as possible. In order for such a programme to be effective:

- the resources available to the FSC will have to be increased; and
- section 5(1) provides that the Superintendent shall not have access to the name of any settlor or to the name or title of any trust or to any publication relating to a trust without an order of the Court, made on the grounds that there is no other manner in which the information can be obtained.

We do not consider that the Superintendent will be able to carry out effective on-site inspections without access to client files to test the processes and procedures of the licensee.

We therefore consider that there is a need for legislative authority for the Superintendent to undertake on-site inspection visits. Such authority must include the ability to review individual client files to ensure that the TLO and regulations or guidance made thereunder are being complied with.

It will be important for the FSC to prepare an on-site inspection manual to ensure a consistent approach across all trustees.

On-site inspections should also verify compliance with the Proceeds of Crime (Money Laundering) Regulations.

12.4.5.4 ***Code of practice***

We consider the most appropriate method of meeting international standards in respect of knowing the identity of the settlor and beneficiaries is via the regulation and supervision of the service provider.

To facilitate the meeting of these standards we consider that the regulatory environment should include an enforceable code of practice or regulations.

This code of practice or regulations should include requirements relating to:

- knowing the identity of the settlor and (if appropriate) the protector and custodian on an ongoing basis;

- knowing, where possible, the identity of the beneficiaries;
- verifying, so far as is possible, the source of trust assets to ensure they are not of illegal origin;
- ensuring that those who undertake trust work are appropriately trained and competent;
- the delegation of any services provided, including provision of powers of attorney;
- the conduct of trustees provided by licence holders;
- the segregation of trust money and assets; and
- the maintenance of books and records including a copy of the trust deed and other documents relating to the trust.

Where areas in the code are adequately covered by any anti-money laundering regulations then the code may simply make adherence to those regulations a requirement under the code of practice so providing regulatory enforcement powers.

12.4.6 **Enforcement of regulations**

As stated above, a number of powers exist under the legislation relating to enforcement. These powers represent a useful range of alternatives for dealing with the variety of regulatory situations that may be encountered.

We do consider that, in addition to the current powers, there should be the ability to petition the court for the winding up of a licence holder or former licence holder in the public interest.

This power would enable the regulator to apply to the court to close down a licence holder or former licence holder where it was continuing to present a risk to clients or the reputation of TCI.

We also consider that a breach of the anti-money laundering regulations should be grounds for disciplinary action, so enabling a breach of the regulations to be the subject of regulatory action even if no criminal prosecution is made.

12.4.7 **Beneficial ownership**

The TOR require us to ascertain the means available to regulators and law enforcement agencies to obtain details of the beneficial ownership of trust assets. We consider that the trust service provider should primarily be concerned with the source of the assets settled into trust. This will require the trust service provider to carry out due diligence to verify the identity of the settlor and co-trustees and (if appropriate) the protector and custodian. The trust service provider should keep the following in TCI:

- a copy of the trust deed and any memorandum of wishes;
- details of the settlor and the source of all assets settled into the trust;
- the identity of the protector and any custodians (if appropriate) and co-trustees;
- the identity of any known beneficiaries;
- minutes of all decisions taken by the trustees; and
- trust accounts or, at the very least, records which would enable trust accounts to be drawn up.

The above will then be available to law enforcement agencies and the regulator in the event of a criminal investigation taking place. We consider the current lack of these requirements is out of line with international standards.

Where the above are not already covered by the Proceeds of Crime (Money Laundering) Regulations, these requirements should either be introduced via new regulation or form part of the anti-money laundering regulations and guidance notes issued.

12.4.8 **Insurance**

The Regulations require the Permanent Secretary, Finance to approve insurers with whom licensees may effect insurance as required by the Act. This has never been done and should be done.

12.4.9 **Legislation and Regulations**

We consider that the TLO and the Regulations should be subjected to a thorough review. In addition to the matters already raised, we noted the following:

- Although section 21 requires a licensed trust company to obtain the approval of the Permanent Secretary, Finance for the transfer of shares, it does not cover a change in beneficial owner. Section 22 requires notification of beneficial ownership, but does not require approval.
- Regulation 5 of the Regulations enables the Permanent Secretary, Finance to approve the filing of a declaration of solvency instead of audited accounts. We understand that no approvals have ever been granted and we cannot envisage circumstances when this would be justified. If the provision is intended to apply to restricted licensees, this should be separately provided for. We recommend the removal of the provision.

We welcome your comments on this site.

Prepared 27 October 2000

13 International co-operation

13.1 Introduction

A number of international standards are in place concerning the provision of co-operation between law enforcement and regulatory authorities. These include those established by international regulatory bodies such as IOSCO, IAIS and Basel, the relevant FATF/CFATF Recommendations, the "Ten Key Principles for International Financial Information Exchange" recommended by the G7 Finance Ministers in May 1998 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. These, together with good practice standards, are referred to in the Guidance Notes. We were not asked to consider international co-operation relating to purely fiscal matters, but we have considered whether the legislation permits co-operation on criminal tax matters.

The principal international standards and good practice standards set out in the TOR and the Guidance Notes are that:

- there are effective gateways in place through which an OT regulator can disclose confidential information obtainable from licensed bodies, including client information, to foreign regulatory authorities;
- the OT regulator is able, through the imposition of conditions, to require that confidential information it discloses to a foreign regulatory authority is not onward disclosed by the foreign regulatory authority without the consent of the OT regulator;
- an OT regulator is able to safeguard the confidentiality of information disclosed to it by a foreign law enforcement or regulatory authority;
- where necessary, MOUs between an OT regulator and foreign regulatory authorities are in place and that MOUs should contain provisions for safeguarding the confidentiality of information provided;
- the law enforcement authority in an OT has a full range of powers to provide mutual legal assistance to foreign law enforcement authorities, including the obtaining of evidence and the provision of assistance at the investigation stage;
- co-operation between law enforcement authorities should cover all financial crimes (including, for example, fraud, insider trading and market manipulation) and not just drugs related offences or money laundering;
- it should be possible for co-operation to be provided even if the activity under investigation takes place and/or is not a criminal offence in the OT;
- international co-operation should extend to tracing, freezing and confiscating proceeds of crime on behalf of overseas authorities. This should be on an "all crimes" basis (including all financial crimes), as envisaged by the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990;
- no assets should be immune from seizure by virtue of OT laws or through asset protection trusts or flee clauses in trusts;
- law enforcement and regulatory authorities should be able to co-operate effectively with each other both domestically and with their counterparts abroad;
- OT regulators can, in the course of their normal duties, obtain information relating to the supervision of licensees which can be disclosed to foreign regulatory authorities through the statutory gateways;
- OT regulators have powers at least equivalent to those contained in the Model "Compulsory Powers Ordinance" annexed to the Guidance Notes to compel the production of information, at the request of foreign regulatory authorities for their own regulatory purposes, from both regulated and unregulated bodies and persons; and
- adequate resources, including legal advice, are available to OT regulatory and law enforcement authorities for the

purposes of international co-operation.

The TOR for this review require us to consider whether the legislation and systems and procedures in place in TCI for international co-operation conform to the above international and good practice standards.

Areas for development and action are contained in the issues and recommendations section below.

13.2 **Confidentiality**

13.2.1 **Introduction**

Regulators are usually subject to a duty of confidentiality that may be imposed:

- under a general statute which preserves the confidentiality of information with respect to business that is of a professional nature;
- in legislation which creates or governs the regulator;
- in legislation which provides for the regulation of particular financial services; and/or
- under common law.

It is appropriate and in accordance with international standards for restrictions to be placed upon the disclosure of confidential information by a regulator. However, in order for a regulator to effectively co-operate with foreign regulatory and law enforcement authorities, there must be gateways through which he can pass confidential information.

13.2.2 **Relevant TCI legislation**

The preservation of confidential information in TCI is primarily achieved through the Confidential Relationships Ordinance ("CRO") (cap 125).

In addition, certain duties of confidentiality are imposed at common law and under those statutes which provide for the regulation of financial services.

There are statutory provisions which enable the disclosure of information to law enforcement authorities in and outside TCI and to foreign regulatory authorities. These are contained in the statutes that provide for the regulation of financial services in TCI.

For the purposes of this Report we have reviewed the following legislation, all of which contain provisions relating to the preservation of confidentiality and/or to international co-operation generally:

- the CRO;
- the CO;
- the BO;
- the IO;
- the CMLO;
- the Mutual Funds Ordinance 1998 ("MFO");
- the Trustees Licensing Ordinance (cap 123) ("TLO");
- the Proceeds of Crime Ordinance 1998 ("PCO");
- the Criminal Justice (International Co-operation) Ordinance (cap 38) ("CJICO");
- the Control of Drugs (Trafficking) Ordinance (cap 35) ("CDTO");
- the Criminal Procedure Ordinance (cap 23) ("CPO");
- the Mutual Legal Assistance (U.S.A.) Ordinance (cap 37) ("MLAT Ordinance");

- the Evidence (Proceedings in Other Jurisdictions) (Turks and Caicos Islands) Order ("EPOJO"); and
- the Fugitive Offenders (Turks and Caicos Islands) Order 1968.

The legislation is covered below and, where relevant, in the section on Money Laundering.

13.2.3 **CRO**

The CRO codifies the English common law duty of confidentiality owed by a bank to its customer, extends the duty to other professional relationships and criminalises a breach of that duty. The Superintendent of the Financial Services Commission and his staff and the statutorily appointed regulators are all subject to the CRO.

The CRO codifies the English common law duty of confidentiality owed by a bank to its customer, extends the duty to other professional relationships and criminalises breaches of that duty.

Subject to certain exceptions set out in section 3(2) of the CRO, a person who divulges or attempts to divulge confidential information to a person not entitled to possession of the confidential information commits an offence.

The CRO applies to public officers and government officials and therefore applies to the Superintendents appointed under the regulatory legislation.

The exceptions in section 3(2) are covered later in this Report.

13.2.4 **CO**

The CO (in Part VIII) makes provision for confidential relationships in relation to exempted companies.

Part VIII of the CO is similar to the CRO, but there are some differences, the following of which are material:

- Part VIII only applies to confidential information with respect to an exempted company;
- the exceptions contain slight differences (this is covered later in this Report);
- section 201 requires that a person, who intends or is required to give, in evidence, any confidential information covered by Part VIII, must apply to the Court for directions; and
- a person who wilfully obtains or attempts to obtain confidential information commits an offence.

Subject to the exceptions set out in section 200(2) of the CO, a person in possession of confidential information who divulges it, or attempts, offers or threatens to divulge it and a person who wilfully obtains or attempts to obtain confidential information, is guilty of an offence.

Part VIII of the CO applies to public officers and government officials and therefore applies to the Superintendent of the Financial Services Commission and his staff.

The exceptions in section 3(2) are covered later in this Report.

13.3 **Co-operation between regulatory authorities**

13.3.1 **Legislative gateways**

The TCI has a number of legislative gateways which facilitate co-operation with foreign regulatory authorities. These are detailed below.

13.3.1.1 ***The BO, the IO, the CMO, the MFO and the TLO***

Section 20 of the BO permits the Permanent Secretary, Finance to require a licensed financial institution to provide him with such information as he deems necessary for the proper understanding of any statement or return furnished by the institution. Subsection (3) provides that no information shall be required under the section with respect to the affairs of any particular customer of a licensed financial institution.

Section 22 and section 23 of the BO provide for the examination of the books and affairs of licensees, at the direction of the Governor or the Permanent Secretary, Finance.

Section 28 of the BO prohibits the Permanent Secretary, Finance and the Superintendent of Banking from disclosing information concerning a licensee, an applicant for a licence or a customer of a licensee acquired in the performance of their duties or the exercise of their functions, other than in accordance with the gateways established in section 29.

Section 29 of the BO provides that the Superintendent of Banking may disclose to an overseas regulatory authority such information which he has acquired in connection with the performance of his duties or in the exercise of his functions as he considers appropriate for the purpose of assisting the overseas regulatory authority in connection with inquiries which the overseas regulatory authority is carrying out.

An overseas regulatory authority is defined as a foreign authority which exercises any functions corresponding to the functions of the Superintendent of banking, insurance and trustees. By virtue of section 29(3), the Superintendent of Banking must not disclose information to an overseas regulatory authority unless he is satisfied that:

- the information requested by the authority is for the purposes of its regulatory functions;
- the request is not for information which is related directly or indirectly to the imposition, calculation and collection of taxes or the enforcement of exchange control regulations; and
- the authority is subject to adequate legal restrictions on further disclosure.

In accordance with section 29(4), the Governor has issued guidelines to the Superintendent concerning the discharge of his functions under section 29.

The IO, the CMO, the MFO and the TLO contain similar provisions to the BO:

- enabling the relevant Superintendent to require the production of and/or access to the books of a licensee and to demand information from a licensee, except insofar as the information is what can be termed "client information";
- prohibiting the Permanent Secretary, Finance and the relevant Superintendent from disclosing information acquired in the course of his duties; and
- establishing a statutory gateway for the disclosure of information to an overseas regulatory authority.

The Governor has issued identical Guidelines under the BO, the IO and the TLO concerning the disclosure of information to an overseas regulatory authority through the gateways.

The only material difference is in the MFO. The Superintendent of Mutual Funds may only disclose information through the statutory gateway after consultation with the Governor in Council.

13.3.1.2 ***CRO***

As stated, the CRO applies to the Superintendents in TCI. However section 3(2)(e) of the CRO provides that the CRO does not apply to confidential information given to or received by any person in accordance with the provisions of any other Ordinance.

In the circumstances, the operation of the CRO is excluded for regulatory purposes where the relevant Inspector discloses information through the regulatory gateways contained in the BO, the IO, the CMO, the MFO and the TLO.

13.3.1.3 ***Companies and limited partnerships***

Neither the CO nor the Limited Partnership Ordinance permit the Registrar of Companies or Limited Partnerships to disclose non-public information to an overseas regulatory or law enforcement authority.

Disclosure of information in respect of companies, trusts and partnerships is discussed further in earlier sections of this report on each of these areas.

13.3.2 **Compulsory powers**

The TCI does not yet have legislation in place that is equivalent to the model Compulsory Powers Ordinance annexed to the Guidance Notes. However, we are advised that the Government is considering equivalent legislation but that no final decision will be made until after United Kingdom Financial Services and Markets Act has been finalised.

13.3.3 **Memoranda of understanding**

The FSC has entered into a MOU with the banking regulators in Belize and Venezuela. In addition, negotiations are ongoing with the authorities in Panama and the Bahamas.

These MOUs are primarily intended to enable the overseas banking regulators to undertake consolidated supervision of banks holding a licence under the BO.

Under the guidelines concerning the use of the gateway provisions issued by the Governor under the BO, the IO and the TLO, where the Superintendent expects to request corresponding assistance from an overseas regulatory authority or expects an overseas regulatory authority to make frequent requests for assistance from him, he should enter into an MOU with the overseas regulatory authority based on the proforma annexed to the guidelines.

As at the date of this Report, no other MOUs had been entered into under the Guidelines.

13.3.4 **Confidentiality of information received from foreign regulators**

There are no specific provisions which require the Superintendents to preserve the confidentiality of information received from foreign regulatory authorities, although as indicated, the Superintendents are all subject to the CRO.

13.4 **Co-operation between law enforcement authorities**

13.4.1 **Legislation**

13.4.1.1 ***MLAT Ordinance***

The MLAT Ordinance gives effect in TCI to the Mutual Legal Assistance Treaty agreed between the UK, on behalf of TCI, and the USA ("the Treaty"). The objective of the MLAT Ordinance is to enable the provision of mutual legal assistance between the USA and TCI for the prosecution, investigation and suppression of criminal offences. Virtually identical legislation is in place in the other Caribbean Overseas Territories.

For the purposes of the Treaty, a criminal offence is either conduct which satisfies the dual criminality test, ie it is conduct which is punishable by imprisonment of more than one year in both TCI and the USA, or it is one of a number of specific listed offences which include insider trading and fraudulent securities practices.

Article 1 of the Treaty defines the scope of assistance to be provided. The Article states that mutual assistance is to be provided for the investigation, prosecution and suppression of criminal offences covered by the Treaty. With the exception of certain civil and administrative proceedings relating to narcotics, the Treaty does not extend to civil matters.

The Treaty can be used both for the obtaining of information and evidence and for search and seizure. However information or evidence obtained cannot be used for purposes other than those stated in the request without the approval of the party to whom the request is made.

A person who divulges confidential information in conformity with a request is given immunity from any action for breach of confidentiality.

The Authority under the MLAT Ordinance in TCI is the Magistrate. The US Authority is the Department of Justice. The Magistrate must notify the Attorney-General of all requests received and the Attorney-General is entitled to appear or take part in any proceedings arising out of the request.

13.4.1.2 ***CJICO***

The CJICO gives substantial effect to the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

The provisions of the CJICO concerning co-operation include:

- the mutual service of process, in proceedings in respect of a drug trafficking offence;
- the mutual provision of evidence in proceedings in respect of a drug trafficking offence;
- the transfer of prisoners to give evidence in proceedings in respect of a drug trafficking offence;

- the issue of search warrants in TCI; and
- the enforcement in TCI of overseas forfeiture orders in respect of drug trafficking offences.

13.4.1.3 ***EPOJO***

This Order enables the Supreme Court to provide assistance to a court or tribunal in another jurisdiction to obtain evidence for criminal (and civil) proceedings.

The Court may, in relation to criminal proceedings, make an order for the examination of witnesses, either orally or in writing, or for the production of documents.

The Order may only be used when criminal proceedings have already been instigated. Therefore, it is not available at the investigation stage.

13.4.1.4 ***PCO***

Sections 35 and 36 of the PCO provide for the enforcement and registration of external confiscation orders.

13.4.1.5 ***CRO and CO***

Section 3(2)(b) of the CRO provides that the CRO does not apply to confidential information given to or received by any person in the course of the taking or giving of evidence, in or outside TCI, for the purpose of or in a trial in respect of an offence triable within TCI or that would be triable in TCI if the offence had been committed there.

As already indicated, section 201 of the CO sets out a process for applying to the Court for directions as to whether a person may give confidential information in evidence in or in connection with any proceedings before a Court in or outside TCI.

13.4.2 **Provision of co-operation**

The TCI received a total of 22 requests under the MLAT Ordinance during the three-year period to 31 December 1999. No statistical records are maintained regarding the response time for such requests as it is considered that there is an insufficient volume of requests received to justify the keeping of records.

13.5 **Requests to other jurisdictions for assistance in criminal matters**

Two requests have been made to other jurisdictions for assistance in obtaining evidence on criminal matters since October 1996.

13.6 **Co-operation between regulatory and law enforcement authorities**

There is no specific provision formally enabling the Superintendents of the FSC to disclose matters to the Royal Turks and Caicos Islands Police or directly to foreign law enforcement authorities.

However:

- section 3(2)(c) of the CRO provides that the CRO does not apply to confidential information given to or received by a police officer in the execution of his duties whether in or outside TCI, investigating any offence committed in TCI or which would have been an offence if committed in TCI;
- section 200(2)(b)(ii) of the CO provides that Part VIII of the CO does not apply to the seeking, divulging or obtaining of confidential information by or to a police officer of the rank of Inspector or above, investigating an offence committed or alleged to have been committed in TCI; and
- section 200(2)(b)(iii) of the CO provides that Part VIII of the CO does not apply to the seeking, divulging or obtaining of confidential information by or to a police officer of the rank of Inspector or above, authorised by the Governor, investigating an offence committed or alleged to have been committed outside TCI, which would have been an offence if committed in TCI.

13.7 **Co-operation on fiscal matters**

Under the MLAT Ordinance conduct which relates directly or indirectly to the regulation, imposition, calculation or collection of taxes is excluded from the Treaty and so co-operation cannot be provided. There is an exemption for tax fraud

and the wilful or dishonest making of false statements to government tax authorities (e.g. by submitting a false tax return) where co-operation is permitted.

The TCI would also provide assistance under the MLAT Ordinance with respect to any fiscal offence for which there is dual criminality.

13.8 Intelligence networks

The TCI participates in the Overseas Territories Regional Criminal Intelligence System ("OTRCIS"). This system, which is operated out of Miami, assists the UK Caribbean Overseas Territories law enforcement personnel to combat local criminality occurring in each individual Territory, as well as the threat posed by drug trafficking and organised crime, including money laundering. OTRCIS provides a secure database on information relating to criminal and suspected criminal activity in the Overseas Territories.

13.9 Support

13.9.1 Resources

There are no TCI Government employees dedicated to the issue of international co-operation.

Legal support on matters of co-operation, both criminal and regulatory, is provided by the Attorney-General's Chambers.

13.9.2 Egmont Group of Financial Intelligence Units

The TCI is not a member of the Egmont Group.

13.9.3 White Collar Criminal Intelligence Team

Additional support is available to the police through the White Collar Criminal Investigation Team ("WCCIT"). This is a joint UK/FBI team which operates out of the FBI offices in Miami. Currently two UK police officers are seconded to the team. These officers are also sworn in as police officers in each of the Caribbean Overseas Territories.

The role of WCCIT is to undertake and assist the police in the investigation of white collar crimes involving the US, the UK and the OTs in the Caribbean.

WCCIT does not have authority to initiate investigations in respect of drugs and drug related offences. There are resources available to assist the OTs with anti-drug trafficking investigations through the drugs liaison network in the regions. There is also an un-appointed Drugs Law Enforcement Adviser for the OTs available to assist with OT related drugs matters.

13.10 Issues and recommendations

13.10.1 Introduction

TCI has a number of Ordinances which provide for the confidentiality of information and for co-operation between regulatory authorities and between law enforcement authorities. However, we consider that the significant number of different legislative provisions make the position unnecessarily complex. It is unclear, for example, why almost identical provisions to those contained in the CRO are enacted with respect to exempted companies in the CO.

We recommend, therefore, that the TCI Government considers enacting consolidating legislation, particularly with regard to co-operation. This would make it much easier for foreign regulatory and law enforcement agencies to ascertain what routes can be used.

The legislation taken as a whole meets many of the international and good practice standards in the Guidance Notes, however, we consider that some enhancements are necessary and that TCI will need to enact legislation providing equivalence to the Model Compulsory Powers Ordinance.

We note, in particular, that with the exception of the MFO, there are gateways through which the various Superintendents can pass information to foreign regulatory authorities, but that these do not extend to client information. We therefore consider that they do not fully comply with international standards.

We are also concerned that there are not sufficient powers to enable the provision of information to a foreign law enforcement authority at the investigation stage when EPOJO will not apply.

The areas where we consider specific action is required are detailed below.

13.10.2 **Co-operation between regulators**

13.10.2.1 ***Scope of existing gateways***

The Guidance Notes require that the statutory gateways should extend to client information. The gateways in the BO, the IO, the CMO, the MFO and the TLO are deficient in that they do not extend to client information. This is inevitable given that the Superintendents under the above Ordinances do not themselves have access to client information without a Court Order or the client's permission.

We recommend that the legislation is amended to enable the Superintendents to access client information and that the restriction upon the disclosure of client information to foreign regulatory authorities is then removed.

The use of the gateways in all of the Ordinances is restricted to cases of regulatory need and the Superintendent is required to be satisfied that the foreign regulatory authority is subject to adequate legal restrictions on further disclosure. This is necessary and accords with international practice. However, the Superintendent of Mutual Funds is required to consult with the Governor before disclosing information to a foreign regulatory authority. We do not know why the gateway provisions in the MFO are different to those in the other regulatory Ordinances. In any event, we cannot see any justification for this restriction and we recommend that it be removed.

Finally, the gateways are not standardised across the regulatory legislation. In each Ordinance, "overseas regulatory authority" is defined as an authority with responsibilities equivalent to those of the particular Superintendent and other superintendents listed. As the lists have not always been brought up to date, there is a danger that the gateways may not apply where a request is received by a Superintendent from a foreign regulatory authority who has functions equivalent to a different Superintendent.

13.10.2.2 ***Compulsory powers***

The Model Compulsory Powers Ordinance was developed by the UK and discussed with the OTs at a number of Attorney-Generals' Conferences. It is designed to provide OT regulators with powers to compel the production of information from both regulated and unregulated individuals and entities in order to satisfy a request for assistance made by a foreign regulator. As regulatory requests are civil rather than criminal, they cannot generally be made under legislation which enables the provision of assistance in criminal matters. Such powers are envisaged by ISOCO and represent good practice.

We do not consider that the legislation in TCI, taken as a whole, provides equivalence to the Model Ordinance. Although the Superintendents may, in certain circumstances, be able to compel production of information from licensees, their powers are not as comprehensive as those provided in the Model Ordinance and there are no provisions which enable the Superintendents to compel the production of information from unregulated persons.

In order to comply with the requirements of the Guidance Notes, we recommend that legislation equivalent to the Model Ordinance should be enacted as soon as possible.

13.10.2.3 ***MOUs***

The TOR require that MOUs are put in place where necessary.

As indicated, the FSC has entered into two MOUs with foreign banking regulators. We consider this to be very positive.

No MOUs have been entered into concerning the use of the regulatory gateways, as envisaged by the guidelines issued by the Governor.

Neither the TOR nor the legislation in TCI require MOUs to be put in place on a general basis and there is no evidence that the lack of MOUs is preventing or hindering the Superintendents from co-operating with foreign regulatory authorities.

Nevertheless, we consider that MOUs are a useful tool and, where in place, facilitate the prompt exchange of information between regulators.

We recommend that TCI FSC considers agreeing further MOUs with those regulatory authorities with whom they have more frequent contact.

13.10.2.4 ***Confidentiality of information received***

The Guidance Notes require that regulators are able to safeguard the confidentiality of information provided to them by foreign regulatory or law enforcement authorities. This is necessary to ensure that, upon a request for information by an OT regulator, foreign regulators are able to comply with conditions which will usually attach to their own gateway provisions.

As indicated, there is no specific statutory provision concerning this, although the Superintendents are subject to the CRO.

We consider that whilst the CRO, and in certain circumstances, the regulatory legislation, probably covers information passed to a Superintendent by a foreign regulatory or law enforcement authority, an opposite argument can be made. In order to ensure that the Superintendents are able to readily satisfy foreign regulatory authorities they are obliged to keep information passed to them confidential, we consider that it would be advantageous for express provision to be made.

We therefore recommend that specific statutory provision is made requiring the Superintendents to safeguard the confidentiality of information received from other regulators.

13.10.3 **Co-operation between law enforcement authorities**

The Guidance Notes require that the law enforcement authorities in each OT have a full range of powers to provide mutual legal assistance to foreign law enforcement authorities. The Guidance Notes indicate that an OT will be able to satisfy this requirement if its legislation provides equivalence to the UK Criminal Justice (International Co-operation) Act 1990 ("the UK Act").

There is no single Ordinance in TCI that provides equivalence to the UK Act. The provisions covering co-operation between law enforcement authorities are contained in a number of different Ordinances. We have reviewed those Ordinances to ascertain whether, taken together, they provide equivalence to the UK Act.

13.10.3.1 ***CJICO***

The CJCO provides for the provision of mutual assistance in respect of drug trafficking offences. Assistance may be given under to CJICO to any other country or territory.

We have reviewed the CJICO against the UK Act and consider that it provides for a significant level of international co-operation in respect of drug trafficking offences. In respect of drug trafficking offences we consider that the CJICO provides broad equivalence to the UK Act.

13.10.3.2 ***MLAT Ordinance***

The MLAT Ordinance enables TCI to provide a wide range of assistance to the US law enforcement authorities. The existence of the MLAT Ordinance and Treaty does not, of course, preclude the US authorities from seeking assistance under the CJICO or through any other channels available to the authorities in other jurisdictions.

Our discussions with the US Department of Justice indicate that the Department is relatively comfortable with the operation of the MLAT Act and Treaty in practice, although they consider that the level of resources available to provide a swift response is limited.

Due to a lack of available data we have not been able to determine if this concern is justified.

13.10.3.3 ***EPOJO***

As stated, the EPOJO permits TCI to provide assistance to foreign law enforcement authorities after proceedings have been commenced. The EPOJO cannot be used at the investigation stage.

We recommend that statutory provision be made enabling assistance to be given in criminal matters at the investigation stage.

13.10.3.4 ***CRO***

The CRO does not apply to confidential information given to, or received by a police officer in the execution of his duties, investigating any criminal offence alleged to have been committed within TCI or that, if it had been committed within TCI, would have been a criminal offence.

Therefore, the CRO can be used to effect co-operation between law enforcement agencies.

However, this is not an enabling provision. It does not specifically provide that a police inspector can provide assistance but simply states that the CRO does not apply to such actions. It would not, therefore, permit information to be disclosed if it was confidential otherwise than by virtue of the CRO.

13.10.4 **Tracing, freezing and confiscation of proceeds of crime**

The CJICO and the PCO provide for the enforcement of overseas forfeiture or confiscation orders.

The PCO depends upon dual criminality and therefore does not extend to conduct that may be a financial crime in a foreign jurisdiction, but which is not an indictable offence in TCI (for example, insider trading and market manipulation). Therefore, the provisions that permit the enforcement of foreign forfeiture orders do not apply to such conduct. This is not in accordance with the Guidance Notes.

We recommend that compliance is achieved by extending the range of financial crimes.

The Guidance Notes also require that assets should not be immune from seizure through asset protection trusts or flee clauses. For the reasons set out in the section of this Report on Trusts, we do not consider asset protection trusts to be significant in TCI. Please see our recommendations concerning flee clauses in the section on Trusts.

Assistance provided under the CJICO relates to drug offences only. Asset seizure under the PCO occurs only after the second or subsequent conviction unless the offender is convicted in any proceedings before the Supreme Court. This does not accord with international standards. We recommend that asset seizure under the PCO can take place on the first offence.

13.10.5 **Co-operation between regulatory and law enforcement authorities**

As indicated, there is no specific provision in any financial regulatory legislation formally enabling the regulator to disclose matters to the police.

Although the CRO does not apply to confidential information given to, or received by a police officer, in the circumstance outlined earlier in this Report, we note that this is not an enabling power. It simply provides that the CRO does not apply. In the circumstances, if information is confidential other than through the application of the CRO, this exception would not assist.

Specifically, the exception to the CRO does not assist in respect of information that the relevant Inspector is required to keep confidential by virtue of the OBTCO or the CMO.

Part VIII of the CO does not permit information exchange in respect of exempted companies.

However, we recommend that specific statutory provision is made enabling the Superintendents in TCI to disclose information to the police.

In addition, whilst the contacts between the FSC and the police are good, in order to demonstrate compliance with good practice guidelines, there needs to be a formal communication process, whereby the police advise the FSC of the findings or investigations relating to fraud and money laundering and we recommend that appropriate procedures are put in place.

13.10.6 **Transparency in co-operation**

Discussions within and outside TCI indicate that the potential gateways for co-operation are not always well understood by those requesting assistance. Failure to utilise the appropriate gateway can lead to delay and the impression of a lack of co-operation.

To address this issue, TCI Government should produce and publish (possibly via the World Wide Web) guidance notes for foreign regulatory and law enforcement authorities detailing the types of co-operation available and the appropriate procedures for seeking the different types of co-operation.

We therefore recommend that TCI Government should produce guidance notes for regulators and criminal authorities in other jurisdictions detailing the types of co-operation available and the appropriate procedures for seeking the different types of co-operation.

13.10.7 **Resources**

Whilst there are no individuals dedicated to the issue of international co-operation, there is no indication that there are

insufficient resources available to provide information when requested.

Concern was however expressed by TCI police of the need for support from outside the jurisdiction in assisting with financial offences, particularly complex cases. In light of these concerns, we consider that there is a need to ensure that TCI is provided with adequate experienced police resources for the investigation of complex financial crime.

13.10.8 **WCCIT**

To facilitate the full assistance of WCCIT in relation to money laundering offences we recommend that the current exclusion of drug related matters from its scope is removed.

We welcome your comments on this site.

Prepared 27 October 2000

14 Anti-money laundering

14.1 Introduction

A number of international standards are in place setting legislative and practical measures that should be taken to combat money laundering. These are contained principally in the FATF 40 Recommendations and the CFATF 19 Recommendations, the Vienna Convention and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990. We are asked to consider to what extent the OTs apply the standards set out in these documents together with those contained in the EC Money Laundering Directive (June 1991).

Our review falls into two parts. The first is a review of the legislation, regulations and guidelines in place. The second is a review of the implementation of the legislation, regulations and guidelines, especially as regards the reporting, handling and investigation of suspicious transaction reports.

14.2 Factual assessment

14.2.1 Legislation

14.2.1.1 *Introduction*

The TCI has three pieces of legislation dealing with money laundering:

- the Control of Drugs (Trafficking) Ordinance 1988;
- the Criminal Justice (International Co-operation) Ordinance 1992; and
- the Proceeds of Crime Ordinance 1998.

14.2.1.2 *Control of Drugs (Trafficking) Ordinance ("CDTO")*

The CDTO was enacted to implement the drug trafficking aspects of the Vienna Convention in TCI. The following money laundering offences were created by the CDTO:

- assisting another to retain the benefit of drug trafficking (section 22); and
- prejudicing an investigation (section 26).

The *mens rea* for the offence of assisting another to retain the benefit of drug trafficking is "knowing or suspecting" that another person carries on or has carried on or benefited from drug trafficking.

The offence provisions apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit offences under the CDTO.

14.2.1.3 *Other provisions of the CDTO*

Sections 4 - 7 of the CDTO enable the Court to confiscate the proceeds of drug trafficking and Sections 10 - 12 give the Court the power to make restraint orders and charging orders.

Sections 20 and 21 of the CDTO establish procedures for registering at Court and enforcing foreign confiscation orders made by the court of a country designated. The list of countries designated is reasonably comprehensive.

The CDTO also provides for production orders (Section 23) and search warrants (Section 24).

Section 22 of the CDTO provides for reporting suspicious transactions to a police officer. The section provides that if a person makes a disclosure to a police officer:

- that disclosure shall not be treated as a breach of any duty of confidentiality imposed by contract; and

- provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

Reporting suspicious transactions is not compulsory under the CDTO.

As its name suggests, the CDTO is concerned with drug trafficking only and its money laundering provisions are therefore limited to those dealing in the proceeds of the underlying (or "predicate") offence of drug trafficking.

There is no tipping off offence in the CDTO.

14.2.1.4 ***Criminal Justice (International Co-operation) Ordinance ("CJICO")***

14.2.1.5 ***General provisions***

The CJICO enables TCI to co-operate with other countries in drug trafficking criminal proceedings and investigations and, in so doing, gives effect to the mutual legal assistance provisions of the Vienna Convention. The CJICO is discussed further in the section of this Report on international co-operation.

The CJICO also provides for the enforcement of overseas forfeiture orders.

14.2.1.6 ***Drug trafficking offences***

Section 14 of the CJICO creates the offence of concealing or transferring the proceeds of drug trafficking and the offence of acquiring another person's proceeds of drug trafficking for no, or inadequate consideration. The latter offence does not extend to possessing or using another's proceeds of drug trafficking.

The *mens rea* for the above offences is "knowing or having reasonable grounds to suspect" that the property represents the proceeds of drug trafficking.

The offence provisions apply to any person. A "person" includes an individual and a corporate body. Therefore both may commit offences under the CJICO.

14.2.1.7 ***PCO***

The TCI has introduced "all crimes" anti-money laundering legislation through the PCO, which was brought into force on 14 January 2000. The money laundering provisions in the PCO apply to "criminal conduct", which is defined as an indictable offence or conduct taking place outside the jurisdiction which would constitute such an offence if it had occurred in TCI. This concept is known as "dual criminality". Drug trafficking offences are specifically excluded.

The following money laundering offences were created by the PCO:

- assisting another to retain the benefit of criminal conduct (section 28);
- acquisition, possession or use of property representing the proceeds of criminal conduct (section 29);
- concealing or transferring proceeds of criminal conduct (section 30); and
- tipping off (section 31).

The *mens rea* for the above offences is as follows:

- the offence of assisting: "knowing or suspecting" that the person assisted is or has been engaged in or benefited from criminal conduct;
- the offence of acquisition, possession or use: "knowing" that the property is or represents another's proceeds of criminal conduct; and
- the offence of concealing or transferring: "knowing or having reasonable grounds to suspect" that the property is or represents another's proceeds of criminal conduct.

Sections 28 and 29 of the PCO provide for disclosing suspicious transactions to a Reporting Authority appointed under Section 27 (see below). Both Sections provide that if a person makes a disclosure to the Reporting Authority:

- that disclosure shall not be treated as a breach of any duty of confidentiality imposed by enactment or rule of law and shall not give rise to any civil proceedings; and
- provided the disclosure is made in accordance with the section, he does not commit an offence in respect of any act done in contravention of the section.

Sections 4 to 9 of the PCO provide for confiscation orders and sections 16 to 18 provide for making restraint and charging orders.

Section 33 enables the Supreme Court to make an Order for the production of material relevant to an investigation into whether any person has benefited from any criminal conduct or into the extent or whereabouts of the proceeds of any criminal conduct on the application of a police officer and section 34 enables a police officer to apply to the Court for a search warrant.

There is, however, no provision which makes it an offence to disclose the fact that an order has been made under the section if such disclosure is likely to prejudice the investigation. We have been advised by the Attorney-General, however, that in his view such a disclosure would amount to contempt of court.

Sections 35 and 36 of the PCO provide for the registering and enforcing external confiscation orders. To date, no jurisdictions have been designated for the purposes of these sections.

14.2.2 **Regulations**

The following regulations have been made:

- the Proceeds of Crime (Money Laundering) Regulations 1999 ("PCMLR").

The PCMLR were made by the Governor under Section 32 of the PCO and came into operation on 14 January 2000.

The PCMLR apply to persons carrying on relevant financial business which constitutes:

- banking business;
- insurance business;
- trustee business;
- mutual fund administration;
- money transmission agents;
- company management or company agent business; and
- any of the activities in Schedule 1.

Schedule 1 covers a number of other financial services activities.

The areas covered by the PCMLR include the following:

- appointing a Money Laundering Reporting Officer;
- the establishment and maintenance of procedures concerning client identification, record keeping and internal reporting; and
- the provision of money laundering training to employees.

Paragraph 3 of Schedule 2 provides an exemption from the required client identification procedures in respect of introduced business where the introducer is regulated by an overseas regulatory authority and is based in a jurisdiction with equivalent anti-money laundering regulations.

No guidance has been produced as to which jurisdictions meet those requirements.

In addition, the PCMLR covers the duty of supervisory authorities and others to report money laundering. In this context, the

supervisory bodies are the five Superintendents of the FSC and the Permanent Secretary, Finance.

The PCMLR apply to those conducting a wide range of financial activities. They apply to business relationships and to one off transactions of US$ 15,000 and above.

The transitional provisions of the PCMLR did not require the identification of customers prior to the Regulations coming into force.

Breaches of the PCMLR are punishable by fines of up to US$ 25,000. The FSC, the Permanent Secretary, Finance and the Superintendents appointed under the various regulatory Ordinances are required to report evidence and suspicions of money laundering activity.

The regulations do not cover the recruitment of employees or the need for an audit of a licensee to assess compliance with the regulations.

14.2.3 **Guidance notes**

The PCMLR are supported by Guidelines issued by the FSC. These effectively constitute the Code of Practice referred to in Section 26 of the PCO. The foreword to those notes states clearly that the guidance given illustrates good industry practice and is not mandatory. Furthermore, the failure to comply with the guidance notes does not mean that a firm has breached the Regulations.

We have been advised by the FSC that the guidance notes are based on those issued by the Central Bank of the Bahamas. They cover the following broad headings:

- background, including a description of what constitutes money laundering and the vulnerability of banks and trust companies;
- the requirements of TCI law;
- recognising and reporting suspicious transactions;
- education and training, including statutory requirements;
- examples of money laundering schemes uncovered world-wide; and
- examples of suspicious transactions.

The guidance notes do not specify the standards expected by the FSC in the area of customer identification, which rely instead on the provisions of Schedule 2 to the PCMLR.

14.2.4 **Fiscal offences**

Fiscal offences are not predicate offences under the PCO owing to the dual criminality requirement, and therefore co-operation cannot be provided. Other offences caught by the PCO, such as fraud, may have a fiscal element. Nevertheless co-operation can be provided.

14.2.5 **Anti-money laundering - framework, system and procedures**

14.2.5.1 ***Reporting Authority***

Section 27 of the PCO provides for the appointment by the Governor in Council of a Reporting Authority comprising 5 members as follows:

- the Attorney-General, as chairman;
- the Collector of Customs or his representative;
- the Superintendent of the FSC or his representative;
- the Commissioner of Police or his representative; and
- the Superintendent of the Criminal Investigation Department or his representative.

The Reporting Authority meets bi-monthly but can meet on an *ad hoc* basis, if required.

Reports of suspicious transactions ("SARs") are required to be made to the Reporting Authority which has nominated the Financial Crimes Unit of the Royal Turks and Caicos Islands Police Force ("RTCIPF") as the designated point for receiving, recording and investigating reports. SARs are made on a form prescribed by the Reporting Authority.

There is no minimum reporting threshold. Transactions, including linked transactions, of US$15,000 or more may not be carried out unless the identification procedures have been followed. Reports may be made if the customer or transaction is declined.

We have been advised that the first two SARs were made in the week ended 5 May 2000.

The PCMLR restricts the ability of the Reporting Authority to disclose information received from a Superintendent, a CO inspector or a person authorised under the IO, the BO or the TLO. The Reporting Authority may only disclose such information in connection with the investigation of any criminal offence or for the purpose of any criminal proceedings.

14.2.5.2 *Financial Investigations Unit*

There is no specialist Financial Investigations Unit. Financial investigation is undertaken by the Financial Crime Unit ("FCU") of the RTCIPF which has a wider remit.

The FCU comprises a detective inspector seconded from the United Kingdom police force, a detective sergeant and a detective constable. The two officers have received training in relation to the handling of informants and further training is planned. This will involve an officer from the Cheshire Financial Investigation Unit spending a month in TCI training the team and others from the drugs squad.

14.2.5.3 *Attorney-General's Chambers*

The Attorney-General is the Chairman of the Reporting Authority. His Chambers contain five further attorneys and a trainee attorney.

14.2.6 **Monitoring developments in anti-money laundering techniques**

The monitoring of developments in the fight against money laundering, including new money laundering typologies, is primarily done via participation in the CFATF. The TCI is not a member of the Egmont Group but is considering becoming affiliated.

The Reporting Authority is responsible for monitoring the general development of anti-money laundering policy and for monitoring developments within the FATF and CFATF.

14.2.7 **Other measures to avoid money laundering**

There are no direct measures to detect or monitor cross-border transportation of cash and bearer instruments. However customs have powers to search and seize cash.

There are no requirements to report transactions above a certain value.

There is no measurement system in place for recording the international flow of cash and bank transfers, into or out of TCI.

The TCI does not distinguish between money launderers who are public officials and others.

14.3 **Issues and recommendations**

14.3.1 **Introduction**

The TCI has recently introduced a number of legislative provisions designed to bring it into compliance with international standards, including modern all crimes anti-money laundering legislation. The legislation, taken as a whole, is reasonably extensive and contains much of the material and covers most of the issues that we would expect in a jurisdiction that is fully compliant with international standards. We consider that this is positive evidence of TCI's commitment to prevent money laundering.

However, we recommend that some enhancements should be made to the CDTO and these are addressed below.

As the legislation, framework and systems are very new, we have not been able to undertake an effective review of how they are working in practice and we are therefore unable to make many recommendations in this area. The FSC will need to actively monitor compliance. We consider that the most important areas for the FSC to monitor will be trust and company administration. It would be worthwhile for a further review of the systems and procedures to be undertaken once some empirical evidence is available.

Additionally, the recommendations contained in the other sections of this Report relating to changes in the regulatory structure and international co-operation should be implemented. Regulatory on-site visits should also cover compliance with the PCMLR.

14.3.2 **Legislation**

14.3.2.1 ***CDTO and CJICA***

As indicated above, the offence of concealing or transferring the proceeds of drug trafficking and the offence of acquiring another person's proceeds of drug trafficking for no or inadequate consideration are created in the CJICA. However, the offences of tipping off and possessing and using another's proceeds of drug trafficking are not provided for in either the CDTO or the CJICA. In these respects TCI does not yet fully comply with FATF Recommendation 17 and article 3 of the Vienna Convention.

The *mens rea* for the CDTO offence of assisting another to retain the benefit of drug trafficking is "knowing or suspecting" that the other person carries on or has carried on or benefited from drug trafficking. We consider that the *mens rea* for the offences should be extended to cover a person who has "reasonable grounds to suspect". Provided that the same change is made to the PCO, this will bring TCI into line with FATF Recommendation 4.

The *mens rea* for the CJICA offence of concealing or transferring the proceeds of drug trafficking and the offence of acquiring another person's proceeds of drug trafficking for no or inadequate consideration is "knowing or having reasonable grounds to suspect" that the property represents the proceeds of another's drug trafficking. This complies with international standards.

We recommend that TCI should introduce compulsory reporting of suspicious transactions in relation to drug trafficking to assist in creating a culture of disclosure in appropriate circumstances.

14.3.2.2 ***PCO***

Sections 35 and 36 of the PCO provide for registering and enforcing external confiscation orders. As no countries have yet been designated, TCI is not in full compliance with FATF Recommendation 38.

As indicated, the *mens rea* for the offence of assisting another to retain the benefit of criminal conduct is "knowledge or suspicion" and the *mens rea* for the offence of acquisition, possession or use of property representing the proceeds of criminal conduct acquisition is "knowledge". We consider that the *mens rea* for each offence should extend to "having reasonable grounds to suspect" as envisaged by CFATF Recommendation 4.

We note that TCI does not distinguish between launderers who are public officials and others, as envisaged by CFATF Recommendation 5. Sentencing discretion should enable the judiciary to set higher penalties for public officials who commit money laundering offences. We do not know whether sentencing policy reflects this.

There is no requirement to report transactions above a certain value. Whilst such a system is envisaged by FATF Recommendation 23 and CFATF Recommendation 14, the Recommendations do not make such a provision mandatory. We consider that a decision upon whether such a reporting regime should be implemented is for the jurisdiction itself to take rather than an international standard.

We recommend that the *mens rea* for the offences of assisting and acquisition should be extended to "having reasonable grounds to suspect".

14.3.3 **Regulations**

14.3.3.1 ***PCMLR***

We consider that the exemption from the requirement to verify the identity of an existing client is a weakness and not in accordance with good practice. It is possible that fictitiously named accounts or other relationships could have been

established prior to the date the regulations came into effect and this exemption would permit their continued operation.

The applicability of the PCMLR should be extended to cover persons providing registration and registered office services for limited and exempted limited partnerships.

We recommend that the PCMLR should cover the recruitment of employees and compliance audits of licensees. It is essential that the person undertaking the compliance audit has access to client files. This is required to bring the regulations into compliance with FATF Recommendation 19.

We have referred to the restriction imposed upon disclosure of information received by the Reporting Authority from a regulator. In effect, this prevents the Reporting Authority from disclosing information to foreign regulatory authorities. We consider this to be acceptable provided that our recommendations concerning regulatory gateways, made in other sections of this Report, are implemented.

14.3.4 **Guidance notes**

We consider that the Money Laundering Guidelines to be comprehensive and have no recommendations to make in respect thereto. As indicated, given their relatively recent introduction, it is too soon to assess how well they will work in practice.

14.3.5 **Framework, systems, procedures and resources**

14.3.5.1 ***Reporting Authority and FCU***

The membership of the Reporting Authority is broad and, provided it meets regularly, this should enable it to adequately fulfil its policy role.

Only two SARs have been made to date and it is therefore too early to assess the work of the Reporting Authority or the FCU.

We do, however, recommend that the Reporting Authority and the FSC should establish a monitoring system for suspicious activity reports weighted by volume of business. The results should be used to focus monitoring and compliance.

The FSC should establish procedures for compliance monitoring focused on customer identification and the monitoring systems for suspicious activity within regulated businesses.

14.3.5.2 ***Attorney-General's Chambers***

It is too early to assess whether the AG's role as Chairman of the Reporting Authority will produce a significant workload for him and his Chambers and the adequacy of the resources of Chambers cannot be assessed at this time.

14.3.6 **Monitoring developments in anti-money laundering techniques**

The limited resources and lack of a formalised process for monitoring developments means that TCI may not always be up to date.

14.3.7 **Monitoring of compliance by regulated institutions**

In respect of FATF Recommendation 27, we consider that the testing of compliance should form part of the on-site inspection process of the regulator. As part of the compliance process, it is vital that the FSC has access to client files.

14.3.8 **Business awareness**

We consider that the fact that no suspicious transaction reports have been made under the CDTO may be indicative of a lack of understanding of the legislation by the private sector. The introduction of the PCMLR must therefore be accompanied by a formal training workshop(s) for the private sector advising them of their responsibilities under the legislation and regulations.

We are pleased to note that the Reporting Authority recently arranged a conference on money laundering for the local industry which included speakers from other jurisdictions.

14.3.9 **Other regulations**

The lack of effective on-site inspection programmes for licensed institutions means that FATF Recommendation 26 and

CFATF Recommendation 11 are not being fully complied with. Recommendations in relation to this are contained in the relevant sections of this Report.

The current lack of a regulatory system for securities and investment business is not in accordance with FATF Recommendation 29. Our recommendations in relation to this are contained in the relevant section of this Report.

14.3.10 **Cross-border flows of funds**

As indicated, there are no direct measures to detect or monitor the cross-border transportation of cash and bearer instruments.

Whilst such a detection system is envisaged by FATF Recommendation 22, the Recommendation does not make the provision mandatory. We consider that the implementation of such a system is an option, rather than an international standard.

Nevertheless, we consider that TCI should consider imposing a requirement upon its licensed banks and other relevant institutions to report cash flows to and from abroad, in accordance with FATF Recommendation 30 and CFATF Recommendation 15.

We welcome your comments on this site.

Prepared 27 October 2000

Appendix 1

PREAMBLE: REVIEW OF FINANCIAL REGULATION IN THE CARIBBEAN OVERSEAS TERRITORIES AND BERMUDA

The Overseas Territories' White Paper proposes establishing a renewed contract between the UK and the Overseas Territories (OTs). A modern and effective partnership should be built upon the foundations of responsibilities on both sides, coupled with the UK assisting the OTs where necessary, and the OTs exercising control over their own lives in a responsible way.

The UK is pledged to look after the OTs' interests internationally. This goes hand in hand with the OTs meeting accepted international standards, and playing a responsible role in the international community. In the area of offshore financial services, some of the OTs are significant players in their own right. The business conducted in offshore centres is often linked intrinsically with activities regulated in other countries, including the UK and our key international partners. The quality of regulation in the OTs has an indirect or direct effect on people, firms, and markets in other countries, as well as the international financial system.

The Terms of Reference provide for an indepth independent review by experts to assess progress made in the regulation of the offshore sector, and to make further recommendations on how to deal with outstanding issues. HMG circulated Guidance Notes to Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands which indicate accepted international standards and good practice in financial regulation. Following consultation with these OTS, the Guidance Notes and Terms of Reference for the review of financial regulation in the OTs have been revised.

2 September 1999

TERMS OF REFERENCE FOR THE REVIEW OF FINANCIAL REGULATION IN ANGUILLA, BERMUDA, BRITISH VIRGIN ISLANDS, CAYMAN ISLANDS, MONTSERRAT AND TURKS AND CAICOS ISLANDS

PURPOSE OF THE REVIEW

To assess Overseas Territories' (OTs) performance against international standards and good practice as set out broadly in the Guidance Notes.[3]

To make recommendations for improvement where the OTs fall below these standards.

REGULATION OF FINANCIAL ACTIVITY

The review should list separately the type and composition of offshore financial services business in each OT ie. Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos Islands. It should ascertain what legislation, regulations, rules, guidance, systems, and procedures (statutory or otherwise) govern the regulation and supervision of the:

- banking sector;

- insurance sector;

- securities sector, including mutual funds and stock exchanges.

This assessment should cover the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulation and laws.

The review should evaluate to what extent arrangements in the OTs meet standards advocated by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to relevant standards provided by these bodies are broadly set out in the

Guidance Note covering this section. The review should consider the adequacy of the system of supervision relative to the objectives of an OT's financial services regulation. It should comment on the existence and adequacy of depositor and investment protection schemes. The review should determine whether further action is required by any territory in order to meet the standards broadly set out in the relevant Guidance Note, and prioritise recommendations.

REGULATION OF COMPANIES, PARTNERSHIPS, TRUSTS

The review should supply a breakdown of the type and composition of the company, partnership, and trust sectors in each OT, including company and trust service providers and formation agents, the involvement of professionals (accountants and lawyers), and the scale of activity. It should determine and assess the legislation, framework, systems, rules, regulations, guidance and procedures in place which provide for the regulation of activity in these sectors. The review should establish whether these arrangements conform to good practice and standards outlined in the relevant Guidance Note, which in turn refers to the principles set out in: the Basel Committee on Banking Supervision; International organisation of Securities Commissions (IOSCO); the Financial Action Task Force 40 Recommendations; Caribbean Financial Action Task Force Aruba Recommendations, the International Accounting Standards Committee, the G22 report on Transparency and Accountability (October 1998), IMF Guide to Progress in Strengthening the Global Financial Architecture (April 1999) and the OECD Principles of Corporate Governance.

The review should evaluate the appropriateness of the regulatory measures in place, including the monitoring, supervision, and regulation of activity, as well as the enforcement of rules, regulations, and laws.

Furthermore, it should ascertain the means available to regulators and law enforcement agencies to obtain details about the beneficial ownership of assets controlled by companies, partnerships and trusts. The review should detail the type of information available on the activities of company, partnership and trust. It should determine whether the mechanisms in place are sufficient. The review should also consider whether further action is required by any territory to meet the standards broadly set out in the Guidance Note, and prioritise recommendations.

INDEPENDENT REGULATORY AUTHORITIES

The review should evaluate to what extent regulatory authorities comply with accepted international standards advocated, principally, by Basel, IOSCO, OGBS and IAIS.

In particular, the review should evaluate whether regulatory authorities are accountable, independent and free from business and political influence, and properly staffed and budgeted for, with an independent source of income. It should determine whether the authority is detached from the marketing of financial services and where this is not so any impact this may have on the ability of the regulatory authority to regulate the sector objectively. The review should assess to what extent each regulatory authority possesses the necessary powers and uses them effectively to: set standards, rules, guidance, and to make proposals for legislation relating to all financial activity under its control; grant, suspend, and withdraw licences; monitor, supervise, investigate and regulate activity; cooperate with requests for assistance from foreign authorities and; enforce rules, regulations, laws by taking enforcement action, and the extent to which they can liaise with law enforcement authorities in the sharing of information. The review should consider which activities fall under the responsibility of the regulatory authority, and whether the regulatory net covers all financial activities. it should comment on the resources available to the authority, both for the purpose of recruitment, training and retention of staff and its infrastructure, such as the use of technology.

The review should consider what legal advice is available to the authority and its effectiveness in helping the OT government to regulate the sectors.

INTERNATIONAL COOPERATION

The review should evaluate the legislation, framework, systems, procedures (statutory or otherwise), rules, regulations, guidance and safeguards for the ability of OT law enforcement and regulatory authorities to cooperate with requests for assistance from foreign authorities. The necessary requirements are broadly set out in the relevant Guidance Note. The review should ascertain what legal advice is available to OT regulatory and law enforcement authorities and its effectiveness in helping the OT government to co-operate in these areas. The review should determine whether further action is required by any territory in any of these areas, and the relative priority of such action.

<u>Cooperation between regulatory authorities</u>

The review should consider whether there are effective 'Gateways' provisions in place; OTs' powers to obtain information,

including by compulsion; ability of foreign authorities to take voluntary testimony from OT residents; an OT's ability to safeguard the confidentiality of information provided by foreign counterparts; provisions governing conditions under which information may be passed to overseas jurisdictions; whether effective Memoranda of Understanding exist, where required to underpin cooperation.

Cooperation between law enforcement authorities

The review should assess the extent of cooperation to which OT law enforcement authorities can obtain evidence on behalf of their foreign counterparts, and exercising other available mutual legal assistance powers, stating the mechanisms and OT authorities involved; an OT's ability to assist foreign authorities in tracing, freezing and confiscating proceeds in accordance with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (November 1990), even if the underlying conduct takes place outside the OT; the effectiveness of Mutual Legal Assistance Treaties with the USA where applicable, and the provision of basic statistics on the volume of requests for assistance made and received; powers to assist foreign law enforcement authorities in investigating all crimes before criminal proceedings have been instituted; ability to safeguard the confidentiality of information provided to OT authorities; whether effective Memoranda of Understanding exist, where required to underpin co-operation.

Cooperation between regulatory and law enforcement authorities

The review should evaluate whether there is effective cooperation

between law enforcement authorities and financial regulators, both domestically and abroad, as specified by the G7 key 10 principles. It should also consider the ability of OT regulatory and law enforcement authorities to determine the beneficial ownership of companies, trusts and partnerships.

MEASURES TO COMBAT MONEY LAUNDERING

The review should establish what legislation, framework, systems and procedures (statutory or otherwise) exist in the OT to combat money laundering, and types of offences caught by the legislation. It should determine which, if any, fiscal offences committed in the jurisdiction or overseas constitute a predicate offence for the purposes of money laundering.

The review should evaluate the effectiveness and adequacy of these arrangements, in terms of how they meet the standards broadly set out in the relevant Guidance Note, which in turn refers to: 1988 UN Drugs Convention; FATF 40 Recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (November 1990), and CFATF Aruba Recommendations. Furthermore, it should consider to what extent the OTs apply standards set out by the EC Money Laundering Directive (June 1991), the standards on which UK anti-money laundering legislation is based.

Specific consideration should be given to those offences considered predicate for the purposes of money laundering legislation; whether OTs have regulatory legislation in addition to the principle money laundering offences, and if not, whether guidelines and/or Codes of Practice exist (statutory or otherwise); their systems for reporting suspicious transactions and identifying customers; the institutions obliged to report; how reports are dealt with; and within what timeframe. The review should consider how this information is disseminated and shared with foreign counterparts. It should evaluate ability of Financial Intelligence Units (FIUs), or equivalents, to deal with suspicious transactions ie. whether staff have been properly trained and capable of conducting financial investigations and analysis; the resources at their disposal; feedback to the financial institutions.

The review should determine to what extent the AttorneyGeneral's Chambers and judiciary are resourced and capable of handling the volume and types of cases necessary to enforce the money laundering laws. This not only relates to the prosecution of cases but the provision of assistance to foreign jurisdictions in pursuance of money laundering legislation.

FORMAT OF REPORT AND TIMESCALE

FCO, HM Treasury and OT representatives will wish to agree with KPMG the precise format of the report during Phase 1 of the workplan.

KPMG should provide written monthly reports to the Steering Committee (in electronic form) and attend Committee meetings at least during Phases 1, 2 and 5 (dates to be agreed).

10 December 1999

THE SUPERVISION OF THE BANKING, INSURANCE AND SECURITIES SECTORS

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories states that the Overseas Territories (OTs) should seek to implement "*legislation for the effective regulation of the offshore sector which fully meets accepted international standards*". In many cases the OTs have already implemented some of the standards, but no attempt is made here to analyse individual territories' performance to date. Such an analysis is the objective of the independent review foreseen in the White Paper, and to attempt it in the context of this paper would result in a superficial and incomplete impression of where matters stand. Instead, the purpose of this paper is to provide an overview of the framework within which international standards relating to the regulation of banking, insurance and securities business are established, and to offer an outline of the broad standards that have evolved. The paper is not intended to act as a substitute for the study of the detailed documents published by the respective standardsetting organisations, primarily the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). References to these documents can be found in the following text and, specifically, in publications available on the respective websites. The following are also key documents:

- Core Principles for Effective Banking SupervisioBasel Committee Sept 1997

The Supervision of CrossBorder Banking Basel Committee Oct 1996

Insurance Principles, Standards and Guidance Papers IAIS Oct 1998

- Objectives and Principles of Securities RegulatioIOSCO Sept 1998

THE OBJECTIVES OF SUPERVISION

2. The objectives of financial services supervision fall into four broad categories:

· to secure the appropriate degree of protection for consumers of financial services;

· to maintain confidence in the financial system;

· to promote public understanding of the financial system; and

· to reduce the scope for financial crime.

3. The protection of consumers' interests does not assume an absolute objective to prevent financial consumers from losing money, but rather to create an environment where financial risk is better understood, and where there is less chance of consumers taking unnecessary and excessive risks. As stated in a recent Occasional Paper published by the UK's Financial Services Authority, this process requires "*having regard to the differing degrees of risks involved in different kinds of investment, the differing degrees of experience and expertise which different consumers may have in relation to different kinds of regulated activity, and the general principle that consumers should take responsibility for their decisions*"[4]. Delivery of the appropriate environment involves both proper transparency and disclosure by financial institutions, and the effective enforcement of laws, regulations and rules by the regulators.

4. Preservation of confidence in the financial system has at its core the need to mitigate the risk of systemic failure, or of the system falling into disrepute. This will not necessarily be focused on the narrow issue of whether individual depositors or investors are threatened with the loss of money, but on whether the system as a whole might be under threat from the failure of one or more institution. There are circumstances in which individual financial institutions can and should be allowed to fail without fear of a threat to the system, even though there might be losses for the customers of those institutions.

5. The rising tide of financial crime has increasingly posed threats to the integrity of financial systems. This impacts upon both the financial stability of institutions and upon the reputation of individual jurisdictions. Although financial services supervisors are not expected to police the wider criminal laws, it is clearly important for the supervisors to play their part in reducing the exposure of the financial services sector to criminal abuse, and in tackling financial crime and regulatory abuse. This requires OT regulatory authorities to have appropriate investigative powers and specialist enforcement branches, and to cooperate fully with the authorities in other jurisdictions. The responsibility for investigating individual cases of money laundering should, however, fall to OT law enforcement authorities.

THE SUPERVISORY FRAMEWORK

6. Perhaps the single most important aspect that underpins the integrity of the financial services sector is a longterm political commitment to effective regulation and supervision. Without such commitment the regulators will always be starved of the tools needed to achieve an effective result.

7. Fundamental to this process is a willingness to enact comprehensive regulatory legislation, to develop the associated regulations, rules and guidance, and to keep this structure under review to ensure that it stays abreast of trends both in the financial services industry itself, and in the development of regulatory practices. While the individual techniques of supervision and enforcement may vary in order to address the respective distinctive features of the offshore and domestic sectors, the fundamental standards applied to the offshore sector should not differ from those expected for the domestic market. With regard to the offshore sector, it is essential that due regard is paid to the regulatory implications in tandem with any moves taken to facilitate the development of business. Moreover, there should be no attempt to encourage "regulatory arbitrage" by seeking to offer a lighter regulatory regime than exists in competitor jurisdictions.

8. A central part of the legal framework must be provision for an effective, operationally independent and accountable regulatory authority with the appropriate powers to fulfil the objectives identified in section 2. However, legal form alone is not sufficient to provide the basis for an effective regulatory system. There needs also to be an allocation of resources in line with the structure, scale and complexity of the financial services sector. This involves an acceptance of the need to invest in the staff and infrastructure of the regulatory authority in order to ensure that it has appropriate skills and tools to meet the tasks expected of it. It has also to be recognised that there can be no formalistic approach to the funding of the regulatory regime, based, for example, on the direct benefit derived by government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision. By entering the offshore market a jurisdiction has to accept that not only does it have a duty to preserve the reputation and standing of its own financial system, but that it also assumes a wider responsibility to the international community to help ensure the integrity of the global market.

THE DEVELOPMENT OF INTERNATIONAL STANDARDS

9. The increasing internationalisation of financial services in the past decade has led to a drive to establish some common minimum standards of supervision. The application of these standards is seen as particularly important in financial centres with a high proportion of international business, since the failure of supervision there may have far wider implications than simply for the local market.

10. Standards for the supervision of the banking sector have been developed over many years under the auspices of the Basel Committee on Banking Supervision which promulgated the first Basel Concordat in 1975. In recent years there has been a rapid increase in publications emanating from Basel, many of which are intended to represent accepted international standards. Although the Basel Committee is an organisation whose membership comprises the G10 countries, it has a number of "regional" affiliates, not least of all the Offshore Group of Banking Supervisors, which have been closely involved in the development of the standards in recent years. The list of publications produced by the Basel Committee is available on the website of the Bank for International Settlements (www.bis.org). In the context of this paper the most significant of the documents are *The Core Principles for Effective Banking Supervision* (published in September 1997), which delivers 25 basic principles, and *The Supervision of CrossBorder Banking* (published in October 1996), which contains 29 recommendations.

11. In the insurance sector standards are increasingly being established by the International Association of Insurance Supervisors (IAIS). The IAIS was established in 1992 and has membership of about 100 jurisdictions, including several offshore centres. Until 1996 it had no standardsetting powers, but since that time has produced a number of standards and guidance papers. These are consolidated within the *Insurance Principles, Standards and Guidance Papers* published in October 1998. The IAIS standards focus on particular supervisory issues, describing the best or most prudent practices, while the guidance papers are designed to assist regulators to raise the effectiveness of supervision. The IAIS is in the process of developing a website which should be available shortly.

12. The primary international standards body in the securities sector is the International Organisation of Securities Commissions (IOSCO). Like the Basel Committee, IOSCO has been working over many years and published its first *Resolution on the Regulation of Securities Markets* in 1983. Unlike Basel, its membership is big (over 90 countries) and includes a large number of emerging markets and offshore centres. IOSCO's bylaws include clear objectives, with which all members are expected to comply. They include the requirements for members to cooperate, to promote high standards of regulation, to apply the standards rigorously, to establish effective surveillance and enforcement, to maintain just, efficient and sound markets, and to exchange information. In September 1998 IOSCO published its *Objectives and Principles of Securities Regulation* which sets out the 30 Core Principles of securities regulation. In addition, IOSCO has over the years

produced a substantial range of other documents which represent commitments by the membership, guidance or standards, and which are available on its website (www.iosco.org).

13. Although membership of these standardsetting organisations, or their affiliates, has been open to offshore centres, acceptance of, and compliance with the principles that the organisations espouse are essential preconditions for membership.

OVERVIEW OF THE COMMON PRINCIPLES

14. It has to be reiterated that the documents referred to in this paper are essential reading, and it is not the intention of this paper to provide a substitute summary. However, in considering the structure of the overall regulatory regimes required in the OTs it is important to identify the common themes that underpin the regulation of all three sectors. This section seeks to highlight these themes. However, it is important to appreciate that, while there are common characteristics of the regulation of the different sectors of the financial services industry, different skills and processes will be required to effect proper regulation of each sector. The reference documents address these differences.

A. General Principles

a) Regulation should be vested in a properly constituted authority which should be operationally independent from political and commercial interference in the exercise of its functions. However, it should also be openly accountable in the exercise of its powers (see also the separate paper on *Independent Regulatory Authorities*).

b) The regulatory authority should have a clear, adequate, achievable and consistent framework of responsibilities, objectives and powers set by legislation, and it should adopt processes which are fair, consistent, transparent to the public, and demonstrably geared towards achieving the objectives.

c) The regulatory authority should have adequate funding to enable it to acquire the resources (staffing, technology, infrastructure etc) to fulfil its responsibilities. The funding should be available in such form that it does not compromise the authority's independence from both political and commercial pressures.

d) The regulatory authority should have due regard to the need to compete with the commercial sector for skilled staff, and should structure its terms and conditions of employment accordingly. It should also ensure that its staff receives ongoing training.

e) The system of supervision should involve both offsite surveillance and onsite examination. This requires the regulatory authority to have the powers not only to set the scope, content and frequency of routine reporting by regulated institutions, but also to have access, whenever it considers it appropriate, to the books, records, accounts and other documents maintained by the institutions. There should be no secrecy barriers to limit the regulators' access to information.

f) The regulatory laws should establish proper licensing standards and criteria, and the regulatory authority should adopt effective procedures to ensure that applications are reviewed in a thorough and consistent manner. As a minimum this should require the implementation of comprehensive due diligence procedures in relation to controllers, directors and managers of prospective licensees, and a detailed analysis of an applicant's business plan, internal controls, projected financial condition and likely ability to comply with established prudential standards.

g) The regulatory laws should provide for notification of any intended change in ownership or control of a regulated institution, and for such changes to be subject to prior approval by the regulatory authority.

h) The regulatory authority should have the powers to implement and enforce prudential standards both generally across the entire sector, and specifically in relation to individual institutions. For example, this requires that the authority adopt and enforce suitable standards for capital adequacy, solvency, liquidity, risk concentration, asset valuation etc, taking account of accepted international standards and guidelines.

i) The regulatory authority should require institutions to maintain minimum standards of corporate governance, internal controls and operational conduct with the aim of protecting the interests of clients, ensuring proper management of risk, and accepting primary responsibility for these matters. Careful attention should be paid, for example, to the role and responsibilities of the board of directors, the arrangements for delegating authority and responsibility, the separation of duties, the safeguarding of assets and the procedures for internal audit.

j) Regulated institutions should be required to maintain proper books, records and accounts.

k) There should be procedures for dealing with the failure of a market intermediary in order to minimise damage and loss to financial consumers and to contain systemic risk.

1) The regulatory authority should be vested with comprehensive and credible inspection, investigation, surveillance, and enforcement powers, including

- powers to take action to ensure compliance with regulatory requirements;
- powers to impose administrative sanctions for noncompliance;
- powers to initiate or refer matters for criminal prosecution; and
- powers to suspend or revoke authorisation to conduct business.

m) Regulated institutions should be subject to independent external audit in accordance with international accounting standards, and should be required to disclose to the public information regarding their activities and financial position that is comprehensive and not misleading. This information should be sufficient for financial consumers and market participants to assess the risk inherent in individual institutions.

n) The establishment of trading systems, including securities exchanges, should be subject to regulatory authorisation and oversight. Trading should be supervised in a way which ensures that the integrity of the market is maintained. There should be fair and equitable rules which strike an appropriate balance between the demands of different market participants.

o) Market regulation should promote the transparency of trading, be designed to detect and deter manipulation and other unfair trading practices, and aim to ensure the proper management of large exposures, default risk, and market disruption.

p) Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and be designed to ensure that they are fair, effective and efficient, and reduce systemic risk.

q) The regulatory system should set appropriate standards for the eligibility and regulation of collective investment schemes; provide for rules governing their legal form and structure, and for the segregation and protection of client assets; require disclosure necessary for evaluating the suitability of a scheme for particular investors; and ensure that there is a proper and transparent basis for the pricing and redemption of units.

r) The regulatory authority should have the powers and procedures to ensure that regulated institutions take action to protect themselves against criminal misuse, and that they maintain appropriate systems to comply with anti-money laundering regulations.

B. Cross-Border Issues

a) The regulatory laws and supervisory policy and procedures of a jurisdiction should seek to ensure that no institution operating across national boundaries escapes supervision, and that the supervision should be effective. In this context attention should be paid not only to corporate structures that might frustrate effective consolidated supervision (e.g. parallel-owned entities), but also to arrangements where the physical location of the licensee's mind and management differs from that of the regulator (e.g. shell branches).

b) The creation of a crossborder establishment in the regulated sector should be subject to prior consultation and agreement between the home and host regulators. This is essential not only to ensure proper assessment of the application, but also to enable both parties to agree the necessary procedures for ongoing supervision of the institution.

c) The regulatory authority should be empowered to collect both public and nonpublic regulatory information, and to share this in accordance with international principles with domestic authorities and foreign counterparts. Co-operation in the exchange of such information involves exchanges of a routine nature and the provision of assistance in an enforcement investigation, as well as in the event of the emergence of serious problems (see also the separate paper on *International Cooperation*).

d) The regulatory authority should have the powers to assist an overseas regulator in the fulfilment of its functions. This may involve assistance in obtaining information or records, but will also extend to the use of investigative or

compulsory powers on behalf of the overseas regulators. Secrecy or confidentiality provisions in the law of a jurisdiction should not be used as a means of impeding such assistance.

e) There should be no barriers to prevent a home country regulator from undertaking such procedures, and having access to such information in the host country as it considers necessary to undertake the effective consolidated supervision of an international financial services group.

THE FUTURE DEVELOPMENT OF STANDARDS

15. The rate of development of internationally recognised and accepted regulatory standards has accelerated in recent years, and further announcements should now be expected on a regular basis. Therefore, it is important to appreciate that compliance with international standards is not a static or "oneoff" process, but will require regular updating of laws, policies and procedures. With this in mind, regulatory authorities in the OTs should continue to monitor international developments, particularly where they participate in or are affected by the work of one or more of the key international standardsetters mentioned above. They should, in particular, be prepared to recommend changes in legislation where appropriate, and to implement new procedures to ensure that compliance is kept up to date. This applies in all three of the main sectors referred to in this paper.

IMPLEMENTATION

16. Standardsetting is not, by itself, enough. It needs to be accompanied by active monitoring of compliance with these standards, and the commissioning of the independent review of the OTs must be seen in the wider context. The G7 report on *International Financial Architecture*, agreed at Cologne, said:

"*With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation*."

17. The standardsetting regulatory bodies the Basel Committee, IOSCO and IAIS are now working increasingly closely with the IMF and the World Bank. In the field of banking supervision, for example, the Basel Committee, the IMF and the World Bank, working with selected supervisors around the world, have developed a *Core Principles Methodology* text which provides detailed guidance to the IMF and World Bank for their assessments of compliance. It is expected that such assessments will be made for an increasing number of countries and territories around the world; and that the results of such assessments will be used by regulators (see for instance the Basel Committee's consultative paper on a *New Capital Adequacy Framework*) and by the Washington institutions (as a precondition in the IMF's new Contingency Credit Line).

18. An IOSCO Implementation Committee, in which the IMF, World Bank and the regional development banks participate, has been set up to oversee the implementation by IOSCO members of the 30 Core Principles. Cooperation between IOSCO and the international financial institutions is at the heart of this process.

COMPANIES AND TRUSTS

1. There are legitimate reasons for using company and trust vehicles. However, the White Paper "Partnership for Prosperity" (Appendix 2, paragraph 4) states "We shall also press Overseas Territory governments to introduce legislation to improve regulation of company formation and management because, for example, in the absence of proper regulation, complex company structures can be used to disguise the proceeds of crime and other regulatory abuse as well as providing limited liability." The White Paper continues "Company formation agents and company managers need to be required by law to hold key information about the companies for which they have responsibility and to disclose that information to a regulator on request. This will ensure a properly documented paper trail for criminal and regulatory investigations."

2. This paper considers the issues of company and trust regulation relevant to the regulation of the financial system. The paper does not set out a blue-print for Company and Trust Law and regulation as a whole - that would be outside the scope of the Review, and constitute a major undertaking in its own right. The two sectors - companies and trusts - fulfil very different purposes, and their regulatory regimes have evolved in different ways, to meet different objectives. Nevertheless, in respect of their potential as vehicles for abuse, the issues raised by the trust and company sector are similar, and for this reason, this paper treats them in parallel. But the Review may wish to consider them as distinct sectors.

4. The opportunities for companies and trusts to be used for criminal purposes cannot be removed. Effective regulation can help reduce the scope for criminal abuse of such vehicles. There is no single international group of company and trust regulators. Nevertheless, the regulatory principles established by other international bodies in relation to other financial sectors apply equally well to the company and trust sectors:

The principle that financial institutions should know their customers (established by - among others - the Basle and IOSCO standards) applies with particular relevance to situations in which the ownership of assets may be obscured through company and trust vehicles;

FATF Recommendation 11 requires financial institutions "*to take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located)*". The interpretative note to this recommendation states "*a bank or other financial institution should know the identity of its customers, even if these are represented by lawyers....accordingly, recommendation 11 also applies to the situation where an attorney is acting as an intermediary for financial services*". This accepted international standard implies that financial institutions should be able to delve beneath a corporate or trust structure, to establish the true beneficial owner and other relevant parties, and not simply the name of a lawyer acting as an intermediary.

The FATF's Recommendation 25 states "*Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities*";

International standards on accounting, disclosure and auditing practice; covering timeliness in the provision of financial information, completeness, consistency, risk management, audit and control. The relevant standards include those set by the International Accounting Standards Committee; the G22 report on transparency and accountability, October 1998; and the IMF *Guide to Progress in Strengthening the Global Financial Architecture*, April 1999). These standards are particularly relevant when there are obligations to third parties arising;

Standards of corporate governance, reflected in the *OECD Principles of Corporate Governance*, which OECD members, in co-operation with the World Bank and IMF, are committed to promoting amongst non-member countries;

The Home Office report on "*Financial Regulation in the Crown Dependencies*" (The "Edwards Report") makes specific recommendations, based on the internationally accepted principles outlined above, for the company and trust sectors of the Isle of Man, Guernsey and Jersey.

5. Satisfying these principles implies the following;

(i) Beneficial ownership.

It should be possible for law enforcement and regulatory authorities to ascertain, quickly and efficiently, and in advance of formal proceedings, the true owner of assets held by a company or trust, and the source and nature of financial transactions. It is essential to be able to trace the ultimate individual beneficial ownership of companies and to get beyond elaborate structures in which companies are owned by layers of other companies and/or trusts, which obscures the ultimate owner.

In the company sector, this would involve the OT authorities having the means to identify company directors and the beneficial ownership of shares, eg where nominees exist. Effective custody arrangements would need to be in place in relation to bearer shares. In the trust sector, OT authorities should have the means to be able to identify the settlor, the beneficiaries, the trustees, the protector, and the custodian, where applicable, and should be able to obtain a copy of the trust instrument. This would help identify 'sham' trusts, for example. OT authorities should have the means to obtain up-to-date information, and to obtain such information in relation to companies and trusts which might be established in other jurisdictions, yet which might be managed or move to the OT concerned.

(ii) Anti-money laundering systems.

Intermediaries providing corporate or trust services should have in place effective anti-money laundering measures, including "know your customer", record keeping, and staff training requirements. Suspicious transactions involving companies and trusts should be disclosed to a Financial Intelligence Units. (More details on anti-money laundering standards are set out in the 'Money Laundering Guidance Note').

(iii) Transparency of financial arrangements.

Basic financial information relevant to the activities of companies and trusts should be available, quickly and efficiently, and in advance of formal proceedings, to law enforcement and regulatory authorities. Ideally, such information in the company sector should also be available to customers, shareholders, suppliers and lenders, where appropriate. In the trust sector, trustees should ideally be held accountable to the beneficiaries by preparing regular accounts, where appropriate,

which might also be available to the settlor and protector where applicable.

The Review will wish to consider in which circumstances it would be appropriate to require accounts to be produced, in which circumstances such accounts should be made public, in which circumstances abbreviated accounts might be acceptable, and in which circumstances the requirement to produce accounts should not be applied. The latter might apply where single asset holding vehicles exist with no third party involvement.

(iv) Obligations on directors, trustees, and company and trust service providers.

Measures should be in place to ensure that directors and trustees fulfil their "due diligence" obligations effectively, and to prevent nominees from assigning their responsibilities to others through general powers of attorney, and being used as a cover for criminal activities and regulatory breaches. More generally, those who provide corporate and trust services should be licensed, and subject to effective regulation. The "four eyes" principle should apply. The codes which apply to company and trust managers should be complementary, for example to avoid a situation in which inter-linking ownership of company and trust vehicles can be used to obscure beneficial ownership. OT authorities should be able to identify the true directors and owners of a company, and the settlors, beneficiaries, trustees, protectors, and custodians of a trust. The rules, regulations, and laws relating to insolvency and bankruptcy should also be examined by the Review, to ensure that these may not be abused, eg for the purpose of defrauding shareholders.

(v) Investigative and enforcement powers.

OT authorities should be able to apply full investigative powers to those (eg directors, beneficial owners, settlors, beneficiaries, trustees, nominees) who are suspected of criminal activity. This extends to applying the compulsory powers referred to in the paper on 'International Co-operation'. OT authorities should be able to identify the links which may exist between companies and trusts. OT authorities should launch appropriate investigations in the face of bankruptcy and insolvency. More generally, the regulation of company and trust service providers and formation agents needs to be accompanied by effective and independent enforcement powers, including the power to monitor and supervise licensed formation agents and service providers, to inspect their activities, to investigate potential breaches of rules, regulations, and laws, and to take appropriate enforcement action. The latter would include the ability and willingness to take disciplinary action (eg remove licences) as well as to pursue civil and criminal sanctions.

(vi) Removal of impediments to asset tracing and seizure.

Trust and company arrangements should not be able to be used to frustrate the due process of law in attempts to trace and seize assets.

INDEPENDENT REGULATORY AUTHORITIES

INTRODUCTION

1. The White Paper on Britain and the Overseas Territories explains that one of the "key components of the regulatory package we wish to see in place by the end of 1999" is "the establishment of independent regulatory authorities meeting accepted international standards". The Financial regulation checklist appended to the White Paper provides further detail on what this amounts to.

2. Four publicly available papers provide more specific details on what the international community expects from a regulatory authority. These documents are (i) "Objectives and Principles of Securities Regulation" by the International Organisation of Securities Commissions; (ii) "Core Principles for Effective Banking Supervision" by the Basle Committee on Banking Supervision; (ii) "The Supervision of Cross-Border Banking" by the Basle Committee on Banking Supervision and the Offshore Group of Banking Supervisors; (iv) "Insurance Principles, Standards and Guidance Papers" by the International Association of Insurance Supervisors.

KEY FEATURES

(i) Independence

3. Independence is required in order to generate confidence, in particular that all market participants will be treated objectively and fairly, and that rules and regulations will be applied uniformly in such a way as to protect investors and promote orderly market activity. These objectives will not be satisfied unless the regulatory authority is clearly seen to act independently, and to have sole responsibility for regulating market activity.

4. The concept of independence does not imply that regulatory authorities are unaccountable. Instead, it implies that their day to day operations should be free from political or commercial control and influence. These executive operations include all the regulator's key functions, such as (a) deciding to issue, suspend, and withdraw licences; (b) supervising and inspecting the activities of licence holders, including issuing rules and regulations; (c) undertaking investigations; (d) taking enforcement action, and; (e) co-operating with overseas authorities. The regulatory authority should have the necessary powers and ability to regulate all licensed activity.

5. Proper independence requires the regulatory authority to exist as a stand-alone body, rather than as eg a separate unit within the Finance Ministry. Independent regulatory authorities are typically established by statute, which sets out the authority's powers and responsibilities. Those working in the authority, including senior management, should not have any external commercial or political interests or responsibilities (including unpaid directorships). The regulatory authority should not be required to secure OT government approval before exercising its executive powers.

6. Independence extends to the authority's functions. The regulatory authority should not be charged with any political or commercial responsibilities. In particular, the authority should not seek to market its jurisdiction as a place for business to locate. All such hard selling and marketing should be undertaken by a separate body which is not connected in any way with the regulatory authority (again, members of staff should not work in both bodies). Such separate promotional bodies should not be funded by the regulatory authority. Essentially, the job of selling the merits of doing business in a particular OT should be left either to OT governments or to the private sector. It would, however, be open to the regulatory authority to provide information about the regulatory regime in the jurisdiction to potential inward investors.

7. Independence extends to the way in which the authority is resourced. Regulatory authorities should be self-supporting and have their own source of income, independent from Government control. This is often raised through licence fees or another form of industry levy. Where these fees currently account for a large proportion of OT government income, the authority would return any excess income to the government.

8. Independence does not imply isolation. The regulatory authority should consult both the industry and the OT government before seeking to make any changes to broad regulatory policy, and before seeking to make changes which have national policy implications, or which have significant implications for the industry. These implications can properly include considerations of internal and external competitiveness, within the parameters of relevant international standards.

(ii) Accountability

9. Independent regulatory authorities are subject to a number of checks and balances, which in turn ensure that they are held accountable for their actions. In particular;

(a) Statutory objectives. The objectives of the authority should be laid down by statute drawn up by the OT Government. These objectives should reflect the need to satisfy internationally accepted standards of regulation.

(b) Appointments. The authority should operate under a properly constituted board or Commission, which holds a mix of relevant expertise. All board/Commission members should be appointed on the basis of that expertise by the OT Government, or by the Governor in consultation with the OT Government (eg where the Governor retains responsibility for the offshore sector). All key policy decisions should be approved by the board.

(c) Legislation. Legislation covering financial regulation as a whole will often need to be amended or introduced in order to make any significant changes to the regulatory regime. Regulatory authorities do not normally have the power to make such legislation, and will need the support of those who do if significant changes are to be made to the regulatory regime.

(d) Annual report. The authority should produce an annual report available to the public explaining its operations over the past year, how its objectives have been tackled, how resources have been allocated, and how it intends to tackle its objectives in future. This would include publishing a set of audited accounts and possibly a Statement of Principles. The annual report should identify where problems have been encountered in meeting international standards, and how the authority intends to deal with these problems. OT Governments should question the authority in relation to its annual report.

(iii) Functions and powers

10. The documents mentioned in paragraph 2 provide full detail on the types of function expected of a regulatory authority. For the purposes of this paper, it is worth noting simply that the regulatory authority should have sole responsibility and powers in the following areas. These functions relate to the regulation of activity;

(a) Licensing. The regulatory authority should have sole responsibility for issuing, suspending, and withdrawing licences.

This extends to having the powers and ability to investigate whether persons are 'fit and proper' to work for a licensed firm.

(b) Determining how licensed firms and persons should conduct business. The regulatory authority should have sole responsibility for setting conduct of business rules and regulations, and providing guidance for market practitioners. Where legislation is required, the authority should be able to make proposals to OT governments.

(c) Supervising and monitoring licensed activity. The regulatory authority should monitor all licensed activity. This would involve establishing regular (eg quarterly) reporting systems plus a programme of regular and 'surprise' inspections. The regulatory authority should not require the prior approval of any external body before conducting such inspections.

(d) Investigating. The regulatory authority should conduct in-depth investigations into suspected breaches of rules, regulations, and laws. The regulatory authority should have the power to compel the production of information from both licensed and unlicensed firms and persons, in the ways outlined in the paper on 'International Co-operation'. In particular, the regulatory authority should not pursue criminal investigations outside the regulatory function - the law enforcement authorities should be responsible for leading those investigations.

(e) Taking enforcement action. The regulatory authority should have the powers to take appropriate enforcement action in response to breaches of rules, regulations, and laws. This would include the ability to suspend and withdraw licences, the ability to issue directions, and the ability to levy fines. Where criminal activity is encountered, lead responsibility for taking enforcement action would normally fall to the law enforcement authorities in conjunction with the prosecuting authorities.

(f) Co-operating with other authorities. Where serious breaches are encountered, the regulatory authority would be expected to co-operate fully with other authorities within the OT, such as prosecuting and law enforcement authorities. This would essentially involve the regulatory authority handing over information it had obtained before it became clear that criminal activity was at hand, rather than the regulatory authority undertaking any criminal investigations. OT authorities should also co-operate fully with authorities based overseas, in the ways outlined in the paper on 'International Co-operation'.

(iv) Resources

11. The regulatory authority should be properly resourced in order to meet these responsibilities effectively, and a certain critical mass is required. This includes having access to legal and accountancy advice from sources which do not suffer from a conflict of interest. Regulatory authorities should have their own source of stable ring-fenced income, independent from Government or other political control and influence. This income is often raised from the industry in some way.

12. As stated in the paper 'The Supervision of the Banking, Insurance, and Securities Sectors', resources should be allocated 'in line with the structure, scale, and complexity of activity. The funding of the regulatory regime should not be based on the direct benefit derived by the OT Government from the financial services sector. The price to pay must be what it takes to deliver an internationally acceptable standard of supervision'.

(v) Liabilities

13. Regulatory authorities are normally subject to statutory immunity from prosecution, in order to allow them to conduct their regulatory functions more effectively. Other jurisdictions are more likely to recognise this immunity if the regulatory authority matches up to international standards, in the ways outlined above. The converse is also true.

14. Properly resourced regulatory authorities which perform their functions in the ways envisaged by the documents mentioned in paragraph 2 are also much less likely to get into the sorts of situation where their actions might be subject to legal challenge. For example, the regulatory authority should be able to demonstrate that any problems did not arise as a result of substandard regulation.

INTERNATIONAL CO-OPERATION

INTRODUCTION

1. By their very nature, offshore centres conduct business which is linked with that in other financial centres. For this reason, it is important that offshore centres cooperate fully with requests for assistance from authorities in other jurisdictions. This includes both regulatory and law enforcement authorities. The types of assistance referred to in this paper do not include co-operation relating to fiscal matters.

2. The White Paper on Britain and the Overseas Territories explains that one of "the key components of the regulatory package we wish to see in place by the end of 1999" is "powers to ensure that, whatever the secrecy laws, regulators and law enforcement in those Overseas Territories with financial sectors can cooperate properly with their overseas counterparts, including on investigation and enforcement matters".

3. Assistance should extend to;

(i) Regulatory authorities sharing confidential regulatory information held on file or obtainable from licensed bodies.

(ii) Regulatory authorities obtaining information by compulsion from unlicensed bodies, and obtaining client information by compulsion from licensed bodies (where clients refuse to disclose this information voluntarily).

(iii) All such exchanges of information between regulatory authorities to take place under cover of a bilateral Memorandum of Understanding signed by each party, setting out the terms and conditions of assistance, including that the confidentiality of information provided must be safeguarded.

(iv) Law enforcement authorities providing assistance to their foreign counterparts covering all financial crimes (not just those related to money laundering or drugs-related offences), extending to investigative assistance before court proceedings have been issued, and providing for evidence to be obtained on their behalf.

(v) OT regulatory authorities allowing information disclosed to a foreign regulatory authority to be disclosed in turn by them to a foreign law enforcement authority, but only with the OT's prior consent, which may extend to placing conditions on how that information might be used.

GATEWAYS: A PRECONDITION FOR INFORMATION EXCHANGE

4. Where confidential information is exchanged with a foreign authority, or between different authorities within the same jurisdiction, confidentiality should be safeguarded. Confidential information should only be exchanged where provided for in law. Confidential information should only be passed to *bona fide* authorities which can safeguard its confidentiality, and these safeguards should be established in law. Similarly, legislation in Overseas Territories should provide OT authorities with the power to safeguard the confidentiality of information they may have received from foreign authorities.

5. All Overseas Territories should have in place statutory 'gateways' which enable confidential information to be exchanged with foreign authorities. This would include all forms of information of interest to the authorities, including information relating to individuals, bank accounts, trusts, and companies. 'Gateways' legislation should override any secrecy and confidentiality provisions in OT law, to the extent that it should allow confidential information from all sources to be passed to a foreign authority, as long as that authority could in turn safeguard its confidentiality.

6. It is possible that foreign regulatory authorities might be compelled by Court order in their country to disclose confidential information obtained from an OT authority. In these circumstances, the OT authority's prior consent should be sought before any confidential information is disclosed to the Court. If such consent is not forthcoming, the Court should be made aware by the foreign authority that any compulsion to disclose may damage relations between regulatory authorities, to the detriment of future regulatory co-operation, and that this would not be in the public interest.

CO-OPERATION BETWEEN REGULATORY AUTHORITIES

(i) Types of co-operation

7. Gateways *per se* do not provide for adequate co-operation. They simply allow confidential information to be exchanged. Gateways need to be supplemented by powers which enable OT authorities to obtain information (either for their own purposes, or on behalf of foreign authorities), and subsequently to exchange this with foreign authorities.

(i) Supervisory information

8. OT regulatory authorities should be able to obtain, in the course of their normal duties, information relating to the supervision of licensed firms and persons. OT regulatory authorities should be able to exchange this information with their foreign counterparts.

(ii) Voluntary testimony

9. Representatives from a foreign regulatory authority should be allowed to visit an OT with the consent of the OT regulator, and take testimony from individuals and firms who voluntarily consent to being questioned by a foreign regulatory authority. Before approving a request to take voluntary testimony, the OT regulator should be satisfied (i) that the request comes from a *bona fide* foreign regulatory authority, and relates to their regulatory responsibilities, (ii) that the request relates to a specific line of investigation, and (iii) that the confidentiality of any information provided will be safeguarded.

(iii) 'Compulsory' powers

10. These are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT. Following discussions at the past three Attorney Generals' Conferences, a draft Model Ordinance providing for compulsory powers is now well developed (attached at Annex B).

11. Annex A provides more details on how these powers would operate in practice. Because individuals and firms are *compelled* to provide information, there are tight constraints and conditions on the use of these powers, and OT regulatory authorities would have discretion in deciding whether to use them on behalf of an overseas authority. It is worth noting here that;

(i) Compulsory powers should only be used in certain specific circumstances. Incoming requests for information, which will require the use of OT compulsory powers to obtain it, should be vetted by the regulatory authority's lawyers (or an OT Magistrate/Court) within a specific time frame, in order to verify that compulsory powers may be used. Information obtained by compulsion may also be vetted by the regulatory authority's lawyers before final disclosure to a foreign authority;

(ii) Information obtained by compulsion should not be used as evidence against the provider in any subsequent criminal proceedings. The OTs will wish to decide whether to preclude it being used as criminal evidence against third parties;

(iii) Compulsory powers are used only at the very early stages of an investigation, when the investigator does not know whether criminal activity is at hand. Compulsory powers should no longer be used if/when it becomes clear that only criminal activity is involved, and hence that the investigation should be taken forward by the law enforcement authorities (once a suitable request for assistance has been made through other channels);

(iv) Strict terms and conditions on the use of compulsory powers should ensure that they cannot be abused to go on 'fishing trips', that the Overseas Territories retain discretion over their usage, and that they should not be used when it would be more appropriate to go though other channels (eg Mutual Legal Assistance Treaties (MLATs)).

12. Subject to these conditions, information obtained by compulsion may be disclosed to the law enforcement authorities, who as a result may seek to obtain criminal evidence (via other channels). Information obtained by compulsion may help indicate where criminal evidence may be obtained, ie may lay the ground for further requests for assistance via other channels by foreign law enforcement authorities.

13. In summary, these powers are used to uncover facts during the very early stages of an investigation, before it is clear what has taken place, in order to gain a picture of what happened. When it has become clear what happened, the authorities may choose whether to take no action, whether to take disciplinary action, whether to consider civil proceedings, or whether to consider criminal proceedings. Criminal evidence would need to be obtained via other channels (ie agreements between law enforcement authorities) in order to pursue a criminal prosecution. In the UK's experience, compulsory powers are rarely used on behalf of a foreign authority (about ten times per year).

(ii) Memoranda of Understanding

14. It is common practice between regulatory authorities for the terms and conditions of information exchange and

investigative assistance to be set out in a Memorandum of Understanding signed between the authorities which will be co-operating with each other. Memoranda of Understanding usually require requests for assistance to be framed in terms of the specific activities which are being investigated by the foreign jurisdiction - eg they can prevent authorities going on 'fishing trips' in another jurisdiction.

15. Memoranda of Understanding should only provide for the exchange of confidential information when the foreign regulatory authority has demonstrated that they will be able to safeguard the confidentiality of information provided by the OT regulator. Memoranda of Understanding should specify explicitly how confidentiality will be safeguarded, and should set out the terms and conditions of onward disclosure, eg to a foreign law enforcement authority. It is common to allow a foreign regulatory authority to disclose information obtained (eg from an OT regulator) to another foreign authority, but only with the consent of the OT regulator in this example. Memoranda of Understanding should specify what terms and conditions apply to the use of compulsory powers, and this may include specifying how information provided may be used.

16. Memoranda of Understanding are not legally binding documents, nor are they any form of legislation. They are simply an agreement between two regulatory authorities. For this reason, they tend to be tailored to the degree and nature of assistance available in each jurisdiction. Separate MoUs tend to apply to each sector (ie banking, securities, and insurance), although eg an MoU in the securities field would still provide for the exchange of information on bank account details (where this was connected to a breach of regulations or laws concerning securities).

17. Further precise details on international standards relating to Memoranda of Understanding are set out in publications by the Basle Committee, IOSCO, and the IAIS. The IAIS paper 'Insurance Principles, Standards, and Guidance Papers' includes in an Annex a model MoU in the field of insurance. IOSCO have published separate guidance titled 'Principles for Memoranda of Understanding'.

18. An Overseas Territory regulatory authority may still exchange information with a foreign authority if a Memorandum of Understanding is not in place. The terms and conditions of such exchange would need to be agreed on a case by case basis. Memoranda of Understanding essentially provide a framework which allows information to be exchanged without the terms and conditions of such exchange having to be negotiated on each separate occasion. Memoranda of Understanding are therefore more relevant between jurisdictions which exchange regulatory information regularly.

CO-OPERATION BETWEEN LAW ENFORCEMENT AUTHORITIES

(i) Types of co-operation

19. Assistance should be available to foreign law enforcement authorities in relation to all forms of financial crime, rather than just drugs-related offences or money laundering. This would include fraud, insider-dealing, and market manipulation. An OT should be able to provide assistance even though the activity under investigation might not be a criminal offence in that OT. In these circumstances, OT law enforcement authorities will wish to consider whether there is a good reason to provide assistance, or whether it would be in the public interest not to provide assistance.

20. OT law enforcement authorities should be able to provide investigative assistance, and should be able to obtain evidence on behalf of their foreign counterparts. As with regulatory co-operation, assistance should be provided in response to specific requests. Investigative assistance should be made available before court proceedings have been issued, and ideally without the prior need for a Treaty to exist between the countries in question.

21. These objectives would be satisfied if the Overseas Territories were to adopt measures equivalent to those in the UK's Criminal Justice (International Co-operation) Act 1990, which provides for UK authorities to co-operate with judicial and prosecuting authorities in other countries in criminal proceedings and investigations. Many OTs have already introduced equivalent legislation. It is for OTs to decide whether they wish to satisfy the objectives specified here by adopting equivalent legislation or by choosing other means. It is worth noting here that assistance should be available to all *bona fide* foreign law enforcement authorities with genuine requests.

22. It is not common for Memoranda of Understanding to be signed between law enforcement authorities, if only because the types of co-operation required are often provided for by international Treaties. Nevertheless, there is nothing to prevent Memoranda of Understanding from being adopted, especially if OT law enforcement authorities wish to adopt bilateral agreements specifying exactly how assistance might be provided.

23. Memoranda of Understanding are generally easier and quicker to devise and modify than bilateral Treaties. For this reason, an OT is unlikely to be able to co-operate effectively in the ways envisaged with a wide range of countries over a wide range of areas if it seeks to negotiate, sign, and manage a set of bilateral Treaties with all foreign law enforcement

authorities which seek assistance.

(ii) Seizing assets

24. International co-operation should extend to tracing, freezing, and confiscating the proceeds of crime, and their value, on behalf of overseas authorities. Powers to trace assets for authorities in other jurisdictions should be exercisable regardless of banking secrecy and, preferably, on an agency to agency basis as well as through central authority channels. Powers to restrain and confiscate assets which represent the proceeds of crime should be on an all crimes basis, as envisaged in the 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime.

25. No assets should be immune from seizure, either by virtue of OT laws or other arrangements providing for asset protection, or by virtue of arrangements (eg in trust instruments) which require assets to 'flee' to another jurisdiction when there is a chance that they might be seized. These arrangements for asset seizure should apply to all financial crimes, ie not just drugs-related crimes or money-laundering, even though a crime may not have been committed in an OT.

CO-OPERATION BETWEEN DIFFERENT TYPES OF AUTHORITY

26. The G7 have recently adopted a set of ten principles concerning the extent to which regulatory and law enforcement authorities should work with each other, including when different types of authority are based in different jurisdictions. In general, different types of authority (regulatory and law enforcement) should be able to exchange information with each other and to provide each other with investigative assistance, subject to specific terms and conditions set out in Memoranda of Understanding. This does not imply that regulatory authorities should take on the role of 'international tax policemen'.

27. In practice, an OT regulatory authority would assist a foreign law enforcement authority by passing information to a foreign regulatory authority, and allowing them (with prior consent) to disclose this to a law enforcement authority in their jurisdiction. Domestic regulatory authorities do not tend to deal directly with foreign law enforcement authorities. If this arrangement is to work effectively, there need to be effective gateways and working relations between regulatory and law enforcement authorities in the same jurisdiction.

28. This should not, however, prevent OT regulatory authorities from dealing directly with foreign regulatory authorities which also happen to possess certain law enforcement and prosecuting responsibilities. In this instance, the Memorandum of Understanding between respective regulatory authorities would need to specify clearly how any information disclosed might be used.

ANNEX A: COMPULSORY POWERS (OR INVESTIGATIVE POWERS)

A1. Compulsory powers are powers enabling an OT regulatory authority to compel the production of information from both regulated and unregulated firms and persons. In the context of regulatory co-operation, OT regulators should be able to exercise these powers in order to satisfy a request for assistance made by a foreign regulatory authority, even where an offence has not been committed in the OT.

A2. Compulsory powers may be used to obtain information from both licensed and unlicensed firms and persons. This includes ordinary members of the public as well as all financial institutions, companies, and trusts. Compulsory powers may be used to obtain all types of information, including details of beneficial ownership, personal bank details, and personal telephone records.

A3. Compulsory powers override all other secrecy and confidentiality provisions in law - ie they may be used to obtain information from bank accounts, companies, and trusts, even if other laws declare that all such information should not be disclosed. Confidential information would only be disclosed to a foreign regulatory authority if they could safeguard its confidentiality.

Use of compulsory powers

A4. These wide-ranging powers are used at the very early stages of an investigation to gain an understanding of what happened - ie which activities took place where, and who was involved with what. Compulsory powers are used infrequently, as regulatory authorities normally have a clear understanding of what happened, especially where 'know your customer' guidance is actively implemented and licensed firms and persons are willing to assist the authorities.

A5. Compulsory powers are used to undertake fact finding investigations, rather than to obtain criminal evidence. Information obtained by compulsion may be used by the regulator to take disciplinary or civil action. Because information is obtained by compulsion, it cannot be used as evidence in criminal proceedings against the provider.

A6. Furthermore, the 'rules of evidence' which exist in most countries normally prescribe how evidence may be obtained, and this tends to involve questioning under police caution: ie the very nature of compulsory powers normally prevents any information obtained from being used as evidence in criminal proceedings. OT regulatory authorities may in addition wish to specify in Memoranda of Understanding signed with foreign counterparts that information obtained by compulsion cannot be used as evidence in criminal proceedings.

A7. Compulsory powers should not be used to provide assistance to a foreign regulatory authority if it would be more appropriate to use other channels (eg Mutual Legal Assistance Treaties (MLATs)). It is for the requested authority to determine the appropriate channels in line with commitments entered into in any MoUs or Treaties. In practice, compulsory powers should only be used when it remains possible that civil action may be taken as a result of the investigation at hand. As soon as it becomes clear during the investigation that the authorities are faced with only criminal activity, compulsory powers should no be longer used. At this stage, the law enforcement authorities should be left to pursue a criminal investigation (and overseas law enforcement authorities should seek assistance via other channels).

A8. Within this framework, compulsory powers can still be used to assist law enforcement authorities, but only at the very early stages of an inquiry, when it remains unclear what happened, and hence whether civil or criminal sanctions (or none) would be appropriate. Information obtained by compulsion essentially lays the ground for criminal investigations undertaken by law enforcement authorities, should it transpire that criminal activity is at hand. Compulsory powers would be used before a foreign law enforcement authority is in a position to make a request for assistance from an OT law enforcement authority (eg via MLAT).

A9. In this limited sense, the use of compulsory powers may lead to criminal prosecutions. In practice, an OT regulatory authority would not deal directly with a foreign law enforcement authority. Instead, OT regulatory authorities would deal with their foreign counterparts, and then allow (with prior consent) their foreign counterparts to disclose information received to foreign law enforcement authorities.

Who investigates?

A10. Investigations are usually undertaken by the domestic regulatory authority on behalf of the overseas regulator. It is normal for these powers to be vested with the head of the regulatory authority, although an alternative may be to vest them with the Governor or Minister of Finance (depending on who is ultimately responsible for regulation of the offshore sector).

A11. Whoever holds these powers may authorise an officer of his or any other competent person to exercise them. If an OT so wishes, it is possible for an OT regulator to allow an overseas regulator to operate as an authorised agent of theirs and use these powers directly. The decision on who to appoint is normally made on a case by case basis.

A12. Payment of the costs of exercising these powers can be made a condition for providing assistance. This normally happens when the balance of requests tends to be one-sided, rather than domestic and overseas authorities seeking broadly equivalent assistance from each other.

Constraints and discretion in exercising compulsory powers

A13. The exercise of investigative powers after a request is not inevitable, nor is the disclosure of information obtained by their exercise. The powers can only be used to assist an overseas authority having specified regulatory functions, and then only for the purposes of those functions. Assistance should be provided when there is a good reason to do so (this hurdle is normally relatively easy to satisfy).

A14. The information which is obtained through the exercise of investigative powers can be disclosed only if a gateway exists. If there are concerns about how the confidentiality of the information provided will be safeguarded once in the hands of the overseas regulator, or if, as a result of the investigation, doubts have arisen about the authenticity of the overseas regulator's claim to need the information for its regulatory functions, the OT regulatory authority should discuss its concerns with the foreign regulatory authority before disclosing any information.

A15. Assistance should be provided in response to individual requests, which should specify what information is sought and the purpose for which it is sought, including details of the laws, rules or regulations which it is alleged have been breached and of the conduct which gives rise to the breach. The draft model OT Compulsory Powers Ordinance (attached) requires that the following factors be taken into account when deciding whether to exercise compulsory powers on behalf of a foreign authority;

Whether corresponding assistance would be given to the OT;

Whether the inquiries relate to a breach of law which has no parallel in the OT (although assistance may still be provided in these circumstances, if there is a good reason to do so);

The seriousness of the matter in question, the importance to the investigation of exercising compulsory powers, and whether assistance could be obtained by other means (eg MLATs);

Whether it is in the public interest to provide assistance.

A16. Each request for assistance should be vetted by the OT regulatory authority to ensure that it is made by a foreign authority which has the necessary functions and that the request is made for the purpose of its regulatory functions. The requesting authority must demonstrate that a substantial line of enquiry is being pursued - its request should not be a "fishing trip" for information. In practice, the OT regulatory authority would also vet all information obtained by compulsion, to ensure that information disclosed to a foreign authority relates to the specific request made. This vetting would normally be undertaken by the OT regulatory authority's legal advisers. The draft model OT Compulsory Powers Ordinance also provides for an OT Magistrate or Court to approve the use of compulsion, within a short time frame. Under the draft model OT Compulsory Powers Ordinance, it is a criminal offence not to provide information under the exercise of compulsory powers.

ANNEX B: DRAFT COMPULSORY POWERS MODEL ORDINANCE

A Bill entitled:

An Ordinance to make provision for assisting overseas regulatory authorities to obtain information:

ENACTED BY the Legislature of [the Caribbean Overseas Territory] as follows:

1. This Ordinance may be cited as the ******** Ordinance, 1998.

2. In this Ordinance:

"competent authority" means any authority specified in [the Schedule to this Ordinance] [an Order made by the Governor];

["Director" means the Director of Financial Services;]

"foreign regulatory authority" means an authority which, in a country or territory outside [the Caribbean Overseas Territory], exercises functions corresponding to any functions of a competent authority under any Ordinance, or exercises any function [prescribed for the purposes of this section by an Order made by the Governor, being a function] which in the opinion of the Governor relates to companies or financial services;

"Governor" means the Governor in Council;

"regulatory functions" means functions of a competent authority under any Ordinance or any functions corresponding to such functions, and any other functions relating to companies or financial services, not being the functions of assessing, imposing or collecting taxes.

3. (1) Subject to subsection (2), the powers conferred by section 4 are exercisable by the [Director] for the purpose of assisting a foreign regulatory authority which has requested assistance in connection with inquiries being carried out by it or on its behalf.

(2) The [Director] shall not exercise the powers conferred by section 4 unless he is satisfied that the assistance requested by the foreign regulatory authority is for the purposes of its regulatory functions.

[(2A) The [Director] may decline to exercise the powers conferred by section 4 unless he is satisfied that information furnished pursuant to the exercise of those powers will not be used in any criminal proceedings against the person furnishing it (other than proceedings for an offence under section 7 or for an offence of perjury, or for any like offence).]

(3) In deciding whether to exercise those powers, the [Director] may take into account, in particular:

(a) whether corresponding assistance would be given in the relevant country or territory to an authority exercising regulatory functions in [the Caribbean Overseas Territory];

(b) whether the inquiries relate to the possible breach of a law, or other requirement, which has no close parallel in [the

Caribbean Overseas Territory] or involves the assertion of a jurisdiction not recognised by the [the Caribbean Overseas Territory];

(c) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in [the Caribbean Overseas Territory] and whether the assistance could be obtained by other means;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

[(4) For the purposes of subsection (3)(a), the [Director] may require the foreign regulatory authority requesting assistance to give a written undertaking, in such form as the [Director] may determine, to provide corresponding assistance to an authority exercising regulatory functions in [the Caribbean Overseas Territory].

(5) Where a foreign regulatory authority fails to comply with a requirement made under subsection (4), the [Director] may refuse to provide the assistance sought.]

(6) The [Director] may decline to exercise the powers conferred by section 4 unless the foreign regulatory authority undertakes to make such contributions towards the costs of their exercise as the [Director] considers appropriate.

(7) In subsection (3)(a), "relevant country or territory" means the country or territory from which the request for assistance is made.

4. (1) Where in accordance with section 3 the [Director] is satisfied that assistance should be provided pursuant to a request by a foreign regulatory authority, he may in writing direct any person -

(a) to furnish him with information with respect to any matter relevant to the inquiries to which the request relates;

(b) to produce any documents relevant to those inquiries; or

(c) to give him such assistance in connection with those inquiries as the [Director] may specify.

[(3) The [Director] may examine a person on oath and may administer an oath accordingly.]

[(3A) Where a person fails to comply with a direction given under subsection (1) within three days from the date of the direction or such longer period as the [Director] may permit, the [Director] may apply to [a Magistrate] [the court] for an order requiring the person to comply with the direction.

(3B) Where pursuant to a direction given under subsection (1) the [Director] considers it necessary to examine a person on oath, [the Director] may apply to [a Magistrate] [the court] to have that person examined by [the Magistrate] [the court] and the results thereof transmitted to the [Director].

(3C) [A Magistrate] [the court] shall process an application under subsection (3A) or (3B) within seven days and, in the case of subsection (3B), [he] [it] shall transmit the results of the examination to the [Director] within a reasonable period not exceeding fourteen days.]

(4) Where documents are produced pursuant to this section the [Director] may take copies or extracts from them.

(5) A person shall not under this section be required to disclose information or produce a document which he would be entitled to refuse to disclose or produce on grounds of legal professional privilege in proceedings, except that a [lawyer] [barrister or solicitor] may be required to furnish the name and address of his client.

(6) Where a person claims a lien on a document, its production under this section is without prejudice to his lien.

(7) In this section "documents" includes information recorded in any form; and, in relation to information recorded otherwise than in legible form, the power to require its production includes power to require the production of a copy of it in legible form.

5. (1) The [Director] may:

(a) [seek the assistance of the Commissioner of Police in the exercise of his powers under this Ordinance; or]

(b) authorise an officer of his or any other competent person to exercise any of those powers.

(2) No such assistance shall be sought or authority granted except for the purpose of investigating -

(a) the affairs, or any aspect of the affairs, of a person specified by the [Director]; or,

(b) a subject matter specified by the [Director];

being a person who, or a subject matter which, is the subject of the inquiries being carried out by or on behalf of the foreign regulatory authority.

(3) No person shall be bound to comply with a requirement imposed by a person exercising powers by virtue of an authority granted under this section unless he has, if required, produced evidence of his authority.

(4) Where the [Director] seeks assistance or grants an authority under subsection (1), the assistance or authority shall be provided or executed in such manner as the Director may determine; and where the Director grants such an authority to a person other than one of his officers, that person shall make a report to the [Director] in such manner as he may require on the exercise of that authority and the results of exercising it.

6. (1) No information which

(a) is supplied by a foreign regulatory authority in connection with a request for assistance, or

(b) is obtained by virtue of the exercise of powers under this Ordinance, shall, except as permitted by subsection (2), be disclosed for any purpose by the primary recipient, or by any person obtaining the information directly or indirectly from him, without the consent of the person from whom the primary recipient obtained the information and, if different, the person to whom it relates.

(2) Information to which subsection (1) applies may be disclosed:

(a) to any person with a view to the institution of, or otherwise for the purpose of:

(i) criminal proceedings;

(ii) disciplinary proceedings relating to the exercise by a barrister, solicitor, auditor, accountant, valuer or actuary of his professional duties;

(iii) disciplinary proceedings relating to the discharge by a public [servant] [officer] of his duties;

(b) for the purpose of carrying out any duty imposed under any law in force in [the Caribbean Overseas Territory] or by any international agreement to which [the Caribbean Overseas Territory] is a party;

[(c) on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings;]

(d) for the purpose of enabling or assisting a competent authority to discharge any of its functions under any Ordinance;

(e) to the [Governor/Attorney General/public officer approved by the Director] [in the public interest];

(f) if the information is or has been made available to the public from other sources;

(g) in the form of a summary or collection of information framed in such a way as not to enable the identity of any person to whom the information relates to be ascertained;

(h) to a foreign regulatory authority for the purpose of its regulatory functions.

(3) In subsection (1) "the primary recipient" means, as the case may be -

(a) the [Director];

(b) any person authorised under section 5; or

[(c) the Commissioner of Police or any of his officers.]

7. (1) A person who

(a) without reasonable excuse, refuses or fails to comply with any [direction given by the [Director]] [order of [a Magistrate] [the court]] under section 3;

(b) intentionally furnishes false information in purported compliance with any such [direction] [order];

(c) with intent to avoid the provision of this Ordinance, destroys, mutilates, defaces, secretes or removes any document;

(d) otherwise wilfully obstructs any inquiry to which a request from a foreign regulatory authority relates; or

(e) contravenes section 6;

commits an offence.

(2) A person who commits an offence under this section is liable .....

8. No suit shall lie against the [Director] or any person acting under his authority for anything done by him, in good faith, in the exercise of any power or the performance of any function under this Ordinance.

9. This Ordinance shall come into [force] [operation] on such date as the Governor may by proclamation appoint.

MONEY LAUNDERING

INTRODUCTION

1. Money laundering is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises. It is, in effect, the interface between the illegal business sector and the financial sector. Estimates of the size of the phenomenon are hard to come by, but it is generally agreed that it could be in the region of 5% of GDP of the average country.

2. The activity is one of considerable concern for many reasons. If the proceeds of crime are allowed to be lodged unhindered in financial institutions, criminals can gain influence over the institutions and, perhaps eventually control them. Where criminal proceeds are used to buy legitimate businesses, competitors find themselves unable to compete and are driven out of business. Unchecked, money laundering can destabilise financial institutions, sectors and, in certain cases, entire economies. Economic crime can damage financial markets and, thus, the reputation and health of a nation as a whole. It is the concern generated by these implications that have galvanised the international community into making concerted efforts to tackle money laundering.

3. These efforts are highlighted by the following initiatives:

* the 1988 UN Drugs Convention requires parties to criminalise drug money laundering;

* the Financial Action Task Force (FATF) set up in July 1989 by the G7 specifically to develop and promote policies to combat money laundering.

* the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime November 1990;

* the EC Money Laundering Directive of June 1991 requires Member States to prevent the use of their financial systems for money laundering;

* the Caribbean Financial Action Task Force (CFATF) the first regional body to follow the FATF.

4. The White Paper on Britain and the Overseas Territories (Partnership for Progress and Prosperity) noted that the Caribbean Overseas Territories are, in particular, a potential target for money launderers. The OTs should, therefore, have in place comprehensive measures to combat money laundering.

5. The White Paper checklist acknowledged, however, that this is an area in which the OTs have already made good progress. Most have now introduced "allcrimes money laundering legislation". This legislation must, however, be enforced and reviewed regularly. To their credit, all of the OTs are members of the Caribbean Financial Action Task Force and either have, or will shortly undergo, mutual evaluations.

6. The following guidance explains what HMG means by "comprehensive measures to combat money laundering".

INTERNATIONAL STANDARDS

The FATF 40 Recommendations:

7. The 40 Recommendations set the basic framework for anti-money laundering efforts and are designed to have universal application. The principles cover the criminal justice system, law enforcement, the financial system and its regulation and international co-operation. The essential components of the 40 Recommendations are as follows:

* Each country should implement a general framework which ratifies the Vienna Convention, and increases multilateral co-operation on money laundering cases.

* Each country should criminalise money laundering in relation to serious offences, not merely drug money laundering.

* Countries should also put in place measures to enable the tracing, freezing and seizing of criminal assets and the ultimate confiscation thereof.

* The following should be required of all financial institutions, whether they be bank or non-bank institutions:

customer identification "know your customer"

record keeping 5 years

special attention to complex/unusual/large transactions

immunity from prosecution if report suspicion in good faith

internal systems including training and designation of compliance officer

application of these requirements to foreign branches

* Each country should improve spontaneous or "upon request" international information exchange relating to suspicious transactions. This requirement is subject to strict safeguards necessary to ensure consistency with national and international provisions on privacy and data protection.

* Different definitions and standards between jurisdictions should not affect the ability or willingness of countries to provide each other with mutual legal assistance.

* There should be procedures regarding the use of compulsory measures including the production of records by financial institutions.

OTHER RELEVANT STANDARDS

CFATF additional 19 Recommendations:

8. In June 1990 representatives of Caribbean and Latin American States formulated a further 19 Recommendations specifically tailored to regional laws and circumstances. These acknowledged the need to devote adequate resources to this area, the need for competent authorities to specialise in it and that improvements would be ' required to legal systems to enhance the regulation and the role of the financial sector and to improve international co-operation. In particular the CFATF Recommendations urged members to:

* consider the practical evidentiary complications of limiting money laundering to only certain predicate crimes.

* criminalise conspiracy and/or aiding or abetting drug trafficking and money laundering offences.

* to consider making money laundering an offence both where the offender knew or ought to have known the origin of the funds.

* to make money laundering an offence no matter where the predicate offence took place.

* to acknowledge that the fact that a financial adviser is an attorney is insufficient reason to invoke attorneyclient privilege.

EU Money Laundering Directive:

9. Although this has no direct impact on the OTs, it is relevant in so far as it informs the UK law. The EU Money Laundering Directive of 10 June 1991 (91/308/EEC) requires Member States to prevent the use of their financial systems for

money laundering. The EU suggests three main steps to combat money laundering: criminalise it; take measures to identify laundered proceeds with a view to confiscation; pass laws and establish systems to prevent the proceeds of crime being laundered in the first place.

10. The Directive also sets out requirements to be placed on the credit and financial institutions (as defined) of the Member States' jurisdictions. This includes customer identification and retention of records, relating to identification and transactions, for a period of five years. The Directive goes on to require Member States to place a requirement on such institutions to inform the authorities about suspected money laundering activity.

The UK law and practice:

11. The UK implemented the EU Directive by means of the Criminal Justice Act 1993, the Money Laundering Regulations 1993 and earlier legislation. The principal money laundering offences are set out in the Prevention of Terrorism (Temporary Provisions) Act 1989 and the Drug Trafficking Act 1994. The Criminal Justice Act 1988, as amended, contains the money laundering offences relating to the proceeds of crimes other than drug trafficking and terrorism. These are defined as all indictable offences, other than those covered by the 1989 and 1994 Acts, plus the summary offences set out in Schedule 4 to the 1988 Act. The latter include certain lucrative offences relating to sex establishments and the supply of unclassified videos.

12. The principal money laundering offences have a dual purpose. Firstly, to criminalise and so suppress money laundering activity. Secondly, to encourage the reporting of suspicious transactions to the authorities. In this second respect, the offences help to protect the integrity of financial institutions by deterring criminals from lodging proceeds in them, and also help to provide the police with new investigative leads.

Criminal Justice Act 1988, as amended by the Criminal Justice Act 1993:

13. The money laundering offences created by this legislation are as follows:

Assisting another to retain the proceeds of crime: to commit this offence, one must know or suspect that the person in question is or has been engaged in crime, or has benefited from it.

Acquiring, Possessing or using another's proceeds of crime: the offence only applies where the launderer acquires, possesses or uses the property for inadequate "consideration,' (payment). Thus, if one pays full value for the property one does not commit the offence. The provision of goods or services which are of assistance in criminal conduct is not regarded as "consideration".

Concealing another person's proceeds of crime: This includes concealing or disguising property; or converting or transferring property or removing it from the jurisdiction. Carrying out these activities must be for the purpose of assisting somebody to avoid prosecution for a relevant offence or the making of a confiscation order against him/her. Unlike the above offences, all that is required here is "reasonable grounds for suspicion". Thus the prosecution need only prove that the person laundering the proceeds **should have suspected.**

Laundering one's own proceeds: This includes the same activities as concealing another person's proceeds and one must conceal, disguise, convert, transfer or remove property from the jurisdiction for the purpose of avoiding one's own prosecution for a relevant offence or the making of a confiscation order against oneself.

14. The penalties for all of the above offences are fourteen years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction (currently £5,000).

15. The legislation also includes the following offences:

Tippingoff offences: These apply when a money laundering investigation is being, or is about to be, conducted, and where a suspicious transaction report has been made, or a suspicion of money laundering has been disclosed to the authorities. The offence can be committed where one knows or suspects that an investigation is being conducted, or is about to be, or a disclosure has been made.

16. The penalties for tippingoff are five years imprisonment and an unlimited fine on indictment, and six months imprisonment and a fine not exceeding the statutory maximum on summary conviction.

The Money Laundering Regulations 1993:

17. Another essential part of the UK's antimoney laundering defences are the Money Laundering Regulations. They require financial institutions to put in place systems to deter money laundering and to assist the authorities to detect money laundering activities. The Regulations apply to:

* all banks, building societies and other credit institutions,

* all individuals and firms authorised to conduct investment business under the Financial Services Act 1986,

* all insurance companies covered by the EC Life Directives, including the life business of Lloyds of London,

* all other undertakings carrying out any of the range of financial activities listed in the annex to the Second Banking Directive (89/646/EEC, SI 1992,3218). This includes bureaux de change and money transmission services.

18. The Regulations establish criminal offences for those who fail to ensure adequate systems are in place and maintained. Thus, the Regulations require:

* procedures to ensure identification of customers, maintenance of records relating to identification and transactions, or such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering;

* appropriate measures to be taken from time to time to make employees who handle relevant financial business aware of the procedures and the money laundering statutes;

* provision of training for those employees from time to time in the recognition and handling of transactions which may be money laundering.

19. Where an offence is committed by a body corporate, partnership or unincorporated association, the directors and managers and certain other people may be guilty of the offence as well. Penalties for contravention of the Regulations are two years imprisonment and an unlimited fine on indictment and a fine not exceeding the statutory maximum on summary conviction.

Money Laundering Guidance Notes:

20. In addition to the above, the British Bankers Association have produced guidance notes for the industry in association with the Building Societies Association and the law enforcement authorities. Similar guidance notes have also been produced for the insurance and investment business sectors.

COMPLIANCE WITH THESE STANDARDS

21. With regard to the OTs, we have encouraged the OTs to put in place measures equivalent to those in the UK. Most have now implemented the primary legislation. However, work on the essential supporting measures still needs to be completed.

Regulations:

22. Many OTs have opted to implement voluntary codes of practice rather than an equivalent to the UK Money Laundering Regulations 1993 (the Regulations). **To be effective these need to be placed on a statutory footing** providing for criminal offences in the event that monitoring and reporting systems are not created and maintained.

23. Effective operation of the antimoney laundering legislation relies on the vigilance of financial institutions and the reporting of suspicious transactions. While the requirement to put in place monitoring and reporting systems is voluntary, the risk of commercial interest frustrating the intent is concrete. Placing these requirements on a mandatory footing would enable the OTs to ensure that the supporting mechanisms for their money laundering defences could be enforced. It would also send a clear signal to the financial sector that "all money is not simply money", and that certain types of financial activity were unacceptable.

Resources and enforcement:

24. It is clear from the above that the creation of anti-money laundering defences requires considerable input of resources on the part of the financial institutions. This, however, is only one part of the equation. There is little point in requiring the financial sector to report suspicious transactions if there is an inadequate ability on the part of law enforcement to respond. This means that OT Governments must devote considerable resources to ensuring that the law enforcement capacity for analysing suspicious transaction reports and, where appropriate, acting on them is sufficient. This will apply not only to

reports submitted by institutions operating within the jurisdiction, but also to requests for assistance on money laundering investigations from foreign jurisdictions. It is, therefore, essential that the Financial Investigation and Intelligence Units in the OTs are adequately staffed with trained personnel capable of conducting financial investigations and analysis.

25. In addition, it will also be necessary to ensure that the Attorney Generals' Chambers and the judiciary in each OT are appropriately resourced and trained to handle the types of cases which may result from enforcement of the money laundering laws. Again, this relates not merely to prosecutions of offences within the OTs, but also to provision of assistance to foreign jurisdictions in pursuance of the antimoney laundering legislation. Where appropriate, HMG is willing to provide assistance on a short term basis. However, it will be for the OTs to ensure that they budget appropriately for these responsibilities in the future.

International co-operation and confiscation:

26. It goes without saying that a great deal of money laundering involves transactions spanning a number of jurisdictions. The more complex the transactions and the more jurisdictions involved, the harder it is for law enforcement to follow the money trail. The abolition of exchange controls in the late seventies and early eighties, and the rapid improvement in technology means that it is possible instantly to transfer money of any amount or denomination virtually anywhere in the world. Much criminal law is territorially based, and differs from jurisdiction to jurisdiction, so the investigation and prosecution of financial crime and money laundering are very dependent upon mutual legal assistance between states.

27. The confiscation and money laundering legislation which the OTs have been enacting enables many of them to co-operate in international asset tracing investigations, and in the restraint and confiscation of the proceeds of drug trafficking and other crime. Given the percentage of financial business in the OTs which has its origins in other jurisdictions, it is vital that these provisions for international cooperation are fully implemented and, when implemented, operate effectively. At a time when much attention is being focused internationally on offshore centres, it is in the OTs interests to ensure their reputation for being willing and able to assist in tracing, freezing and confiscating criminal proceeds is second to none.

28. HMG is mindful of OT concerns that they may invest considerable resources in providing investigative assistance in proceeds of crime cases, only for the assets to be confiscated elsewhere and retained by the confiscating jurisdiction. In our view, international asset sharing from which some OTs have benefited considerably in recent years provides the best way to ensure that the costs of international casework is shared equitably among cooperating jurisdictions. we strongly support the sharing of confiscated assets relating to all crimes, including drug trafficking, and are working internationally to promote progress in this area. We are happy to discuss continuing concerns about costs with the OTs, and have asked them whether they would be interested in having the Council of Europe Convention extended to their jurisdictions.

Fiscal offences:

29. International standards indicate that money laundering should be criminalised in relation to all serious crime, not merely drug trafficking. The principles leave the definition of serious crime to the individual jurisdictions. At the same time, however, **they also make it clear that such individual definitions should not affect the ability "or willingness" of countries to provide mutual legal assistance.**

30. In the UK we treat tax evasion as a serious crime so it is caught by our confiscation and money laundering legislation. We are aware that different jurisdictions treat specific tax offences in different ways. Experience suggests that this can create problems where money laundering investigations relate in some way to tax offences.

31. The "tax issue" can arise in two ways. First, the predicate offence to which the money laundering offence relates is a tax offence. Assume the predicate offence takes place in jurisdiction A and the money laundering offence takes place in jurisdiction B. A problem is created where the latter does not recognise the tax offence in question as a predicate offence to which its money laundering legislation applies. As a result it will not provide co-operation to jurisdiction A in its investigations. Second, the predicate offence may be another serious crime, such as drug trafficking. It is, however, disguised as a tax related problem to ease the process of laundering. Nonrecognition of tax offences, or non-cooperation on money laundering cases involving such offences can frustrate all sorts of criminal investigations. In either of these scenarios, the inability to cooperate where tax is, or appears to be, involved creates a loophole in the anti-money laundering defences which criminals will utilise.

32. Failure to provide adequate coverage for this issue in the antimoney laundering defences has two serious drawbacks. it makes it easier for criminals to get away with tax evasion, which we regard as a serious crime, and it undermines efforts to combat other forms of offending.

33. There is some concern that the inclusion of tax offences as predicate offences, for the purposes of the money laundering legislation, will place a requirement on financial institutions to know and understand the fiscal regimes in other jurisdictions. This is quite wrong. Under the money laundering offences one is only required to consider whether one has a suspicion of something which would be a crime in one's own jurisdiction. it is also argued that it is difficult or impossible to determine whether a transaction is indeed linked to drug trafficking, tax or any other specific crime. However, the financial institutions and their employees are not expected to investigate suspicions, but to disclose them. As noted above, in the case of the UK, this includes disclosing suspicions of tax evasion. It is worth noting, however, that cooperation on money laundering investigations involving tax offences does not necessarily require such offences to be made predicate. There may be other related offences which fall within the ambit of a jurisdiction's money laundering legislation.

34. There is also an argument that "there is no such thing as the laundering of money from tax fraud', on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime.

35. The UK's confiscation, money laundering and judicial co-operation legislation enables us to trace, freeze and confiscate the proceeds of tax evasion, or any other crime, on behalf of other jurisdictions. Where restraint and confiscation are concerned, the conduct overseas must correspond to an applicable offence in the UK. **However, much investigative assistance can be provided without any dual criminality requirement.** We can, and do, assist in foreign tax evasion cases, including cases where the conduct is not necessarily an offence in the UK.

36. As part of the efforts to combat money laundering, the UK is encouraging others to close loopholes. We would, therefore, encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able.

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3 (Copies of Guidance Notes to be provided to Consultants.) Back

4 Clive Briault: *The Rationale for a Single National Financial Services Regulator* - May 1999 Back

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Prepared 27 October 2000