

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

**A REPORT**

**COMMISSIONED BY THE HOME SECRETARY**

**AND PREPARED BY ANDREW EDWARDS**

**IN CO-OPERATION WITH THE ISLAND AUTHORITIES**

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CROWN DEPENDENCIES**

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# REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES

## PART I

By Andrew Edwards

## SUMMARY AND MAIN RECOMMENDATIONS

### *1 Introduction*

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

Part I presents my assessment. This reflects extensive discussion with the authorities and others in the Islands, in London and in other financial centres. It also draws on professional advice from Mr Richard Chalmers, Professor David Hayton, Mr Guy Sears and Mr Munro Sutherland. To all of these I am most grateful.

Parts II, III and IV, prepared by the Island authorities in consultation with me, are professional prospectuses for the international finance centres of each Island. *I hope that the Island authorities will update these each year and that other offshore centres may be willing to prepare similar prospectuses.*

### *2 The Islands' finance centres*

The development of the Islands' international finance centres in recent decades has been a remarkable success story. Their businesses include banking, investment, insurance, company and Trust business. Customers are now truly international.

The Islands' success has depended importantly on internal self-government. This has enabled them, like other offshore centres, to offer customers tax and other advantages that the large centres cannot readily emulate.

Compared with other offshore centres, they have developed reputations for stability, integrity, professionalism, competence and good regulation. Their links with the UK and Europe have enabled them to be seen as "Offshore UK" or "Offshore Europe".

The finance centres have brought prosperity to the Islands. In Jersey and Guernsey, GDP per head is now well above that in the UK. The Islands' economies now depend heavily on them.

Offshore centres generally are sometimes criticised for maintaining tax regimes that induce businesses to desert onshore jurisdictions and deprive them of tax revenues. These issues lie outside the scope of this Report

The critics also sometimes object to secrecy, poor regulation and poor co-operation in offshore centres. Such criticisms, if applied to the Crown Dependencies, would mostly in my opinion be quite wide of the mark.

### *3 The Islands' reputations*

The professional people I consulted mostly put the Islands in the top division of offshore centres. Many of them commended their standards of regulation, the absence of corruption, and their co-operation with other Jurisdictions, especially in the pursuit of drug-trafficking.

Some raised concerns as well. So too did some of the Islands' people and customers who wrote to me, in

response to my general invitation, about the Review.

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

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

#### 4 *Objectives*

The Islands have a firm objective to be, or to remain, the best governed, best regulated and most responsible of offshore centres as well as the most successful. *It is clearly in the best interests of the Islands, the UK and the international community that the Islands should set, and deliver, high standards in this way.*

#### 5 *Some aspects of government*

The Islands score highly on political stability. For many centuries, they have been dependencies of the British Crown, without ever being part of the UK. Their political systems have been maintained, with limited changes, over many centuries. When the UK joined the European Union in 1973, the Islands decided to remain outside.

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

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

*The Islands' judicial and prosecution systems have shown themselves well able to deal with international finance centre business.* In all the Islands, the First Court of Appeal consists of the Chief Island Judge and QCs from the UK. The final Court of Appeal is the Judicial Committee of the Privy Council in London.

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

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

The Islands have well-developed rules, [?written down and publicly available], to combat corruption and conflicts of interest (a serious problem in many offshore centres). Local critics are indefatigable in attacking anyone thought to have committed such abuses. *Chapter 5 suggests three elements that the rules for members of Parliament and Public Bodies should preferably include where they do not do so already.* These concern withdrawal from meetings and the acceptance of Directorships and other paid positions.

#### 6 *Financial regulation*

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

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

The Isle of Man's FSC dates from 1983. The regulation of Insurance and Pensions was hived off in 1986 to a separate Authority. The Guernsey FSC dates from 1988. In Jersey, the Parliament's Finance and Economics Committee acted until this year as Regulator. But Jersey, too, now has an independent FSC.

*In my opinion, the Islands are right to have independent regulatory authorities. There are strong arguments, especially in small jurisdictions, for having one authority rather than two. This authority should preferably be responsible for company registrations policy as well.*

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

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

These Boards should preferably include members able to represent the interests customers, especially non-residents, as well as people with relevant professional background, and one or two experienced people from outside the islands.

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

*The professional structures in all the islands should preferably include a senior staff member at director level with experience of supervising investment as well as senior staff for banking and insurance supervision; a senior staff member to oversee the new regulation of Trust and Company services providers; an enforcement unit, as in the Isle of Man, responsible for policing the perimeter of unlicensed business.*

The Island authorities all accept an absolute obligation to resource their regulatory bodies adequately. In my assessment, the Jersey FSC needs about 13 extra staff and the Guernsey and Isle of Man about 10 each. In addition about 3 extra staff are needed in each Island to strengthen company regulation. Staff quality and experience are all-important. A mixture of home-grown staff and staff from outside is best.

The terms of reference for the regulatory bodies should preferably include the following objectives:

- to protect customers, non-residents as well as a resident, through effective licensing and supervisions designed to ensure solvency and good conduct of business and to prevent fraud;
- to prevent and combat use of the Islands' facilities for money laundering and other forms of financial crime;
- to co-operate with overseas authorities to these ends;
- to enhance the reputation of the Islands as finance centres;
- to advise the Island's Parliaments on the development of regulatory policy and legislation; and possibly
- to have regard to the economic interests of the Islands.

The actual terms of reference of the Islands FSCs' follow this model fairly closely. *The inclusion in Jersey and Guernsey (but not the Isle of Man) of the economic interests objective needs careful handling.* It is reasonable that the FSCs should have regard to the Islands' economic interests. But the regulators' primary duties must be to protect the interests of customers and prevent abuses. And they should never allow their impartiality to be

compromised. They should not engage in hard selling or aggressive promotion or marketing of the Islands' facilities and industries.

The FSCs should preferably have prosecution powers, as in the Isle of Man. They should have powers to "name and shame" errant licence holders and those who operate without a license. There is also a case for powers to fine.

The Guernsey and Isle of Man regulators have made a special point of good co-operation with regulatory authorities overseas in pursuit of crime or regulatory breaches. Their legislation provides the necessary powers. The Isle of Man authorities might wish, however, to drop the requirement for approval by the Chief Minister before any information relating to individual customers can be passed.

The Jersey authorities have a more cautious approach to co-operation. The new Investment Business Law restricts the information that can be passed to overseas regulators. *I hope that they will repeal this restriction.*

The legislation in all the Islands makes breach of the statutory confidentiality provisions a strict liability criminal offence. This seems excessive. *It would better provide, as in the UK for a defence of due diligence.*

Only the Isle of Man has *customer compensation schemes* in place to protect depositors, investors and policyholders if the providing institutions should fail. In my opinion, *the Jersey and Guernsey authorities too should consider introducing these.*

None of the Islands has *financial services ombudsman schemes* for dealing with customer disputes. In my opinion, *the authorities in all the Islands should consider introducing such ombudsmen (or a joint ombudsman) as well.*

The Jersey authorities have introduced good arrangements for training local staff for work in the finance industries. *The other Islands may wish to do something similar.*

## 7 Banks

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

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

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

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

*The FSCs also accept the need to base supervision more closely on risk assessments for individual banks. Only in Guernsey is there at present any risk-based differentiation in capital requirements.*

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

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

The recent Jersey case involving Bank Cantrade confirms how right the authorities there have been to establish an independent FSC, bring in a new Investment business Law and launch a programme of on-site inspections. *The FSCs in all the Islands should consider introducing Island Rules of Business Conduct throughout the finance sector and a confidential reporting line for regulatory breaches and crimes.*

A recent Guernsey case, involving unlicensed deposit-taking by a fraudster, underlines the importance of having pro-active and well-resourced enforcement units with effective powers of investigation, as in the Isle of Man, in all the Islands' FSCs.

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

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

## 8 Investment and securities business

The FSCs in all the Islands have a policy to regulate investment business to the highest international standards. All are associate members of IOSCO.

Jersey and Guernsey have licensed and regulated collective investment schemes, both open-ended and closed-ended, for over 10 years. They are now extending regulation to the other forms of investment business, including investment managers, investment advisers and stockbrokers. The Isle of Man has regulated all such business since 1991.

In Guernsey and the Isle of Man, the Codes of Conduct which supplement the legislation have the status of rules and the FSCs have power to enforce them. In Jersey, the Codes will not be similarly enforceable. *In my opinion they should be.*

The FSCs license and regulate institutions providing collective investment schemes along broadly UK lines, though with some differences. The UK Treasury has granted "*designated territory*" status to all three Islands. This enables the Islands' industries to market "recognised" open-ended schemes to the general public in the UK.

The issue of licences is carefully controlled. Licence criteria include the usual "fit and proper" assessments. Significant numbers of applications are refused. Permits are also issued for individual schemes. "Recognised" schemes have to meet UK-style requirements. For "non-recognised" schemes, closed-ended schemes and debt issues, the requirements are lighter and less prescriptive.

The Jersey law explicitly does not apply to investment products offered to informed persons not exceeding 50 in number. *In my opinion, this should be re-considered*

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

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

The FSCs generally follow best practice in requiring segregation of client assets and accounts. *In Guernsey, however, the law does not make clear that assets held by a firm in the name of a client are held in Trust and are not available if the firm fails.*

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

Especially in Jersey and Guernsey, outsourcing of back-office tasks is increasingly common. This is a problem for supervision. *The solution may lie in co-operation with regulators or auditors in the jurisdictions where the back-office work is done.*

The legislation gives the FSCs wide powers to investigate. In Jersey, however, notice must be given and there are no rights of entry. The Guernsey law includes no powers to search and seize and no offence of failing to answer. It also needs amendment to reflect the ECHR Saunders judgment on self-incrimination.

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

The Jersey authorities are preparing a new Insider Dealing Law. Securities violation and fraud should preferably be defined as widely as possible so as to ensure that cooperation can be given to overseas authorities. *Offences under the Law should include as in the UK and the Isle of Man, creating false markets in securities.*

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

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

## 9 Insurance and pensions business

Guernsey and the Isle of Man have large offshore insurance sectors, mainly providing captive and life insurance products to non-resident customers. Jersey has only recently begun to compete for such business. The Islands have designated territory status under section 130 of the UK's Financial Services Act, 1986. This



enables their life insurance companies to market their products to UK residents.

The Island authorities all aspire to have well-regulated insurance sectors, suitably attuned to offshore needs. Specialist insurance management companies manage most of the offshore insurers. The authorities regulate mainly through these local managers.

In the Islands as elsewhere, insurance regulators have tended to play a larger part than banking or investment regulators in supporting the industry's progress and developing new products. *In my opinion, this is acceptable but only provided that the regulators scrupulously respect the principles set out in section 6.*

The division of duties between "host" and "home" supervisors is less well specified than in the banking sector. *In my opinion, explicit agreements are needed with the supervisors in parent company jurisdictions.*

The legislation in all the Islands covers the differing needs of (and within) the domestic and offshore sectors by giving wide discretion to the regulators, including substantial "waiver" powers.

The authorities are reviewing their legislation. *In my opinion, consideration should be given to a new structure comprising separate laws for the domestic and offshore business and within the offshore business law, separate provisions for captive and commercial business and life insurance business.*

*The Isle of Man and Jersey authorities should deal at the same time with the other issues on the legislation listed in Chapter 9. In Jersey, the list is extensive and the authorities should move quickly to strengthen or (better) replace their legislation.*

The Guernsey authorities introduced legislation in 1997 for Protected Cell Companies. Such structures offer economies in administration, fees and capital requirements for insurance and investment funds. But there is no knowing whether they would survive legal challenge in Courts outside Guernsey. The Guernsey supervisors have rightly been scrupulous in highlighting this uncertainty. *They should ensure that firms offering the facility are similarly scrupulous.*

The Island authorities vet applications for licenses carefully with a view to admitting quality. On-going supervision depends importantly on scrutiny of annual returns, including audited annual accounts, reports by consulting actuaries and auditors, and business plans. [As in the UK,] on-site inspections are not well developed.

*Chapter 9 lists matters requiring attention in one or more of the Islands, including accounting standards, updating of business plans, solvency margins, actuarial criteria and certificates, whistle-blowing and procedure manuals. Also crucial, especially in long-term insurance, are systems for combating money laundering. The Isle of Man authorities require that the annual Directors' Certificate and Auditors' Report certify full and effective compliance with the Island's money laundering guidelines.*

The authorities' powers to investigate, intervene and petition for winding up of insurers mostly appear satisfactory. *The Jersey authorities, however, need powers to petition the Court to wind up insurers and less cumbersome powers to investigate.*

The Jersey powers to co-operate with overseas authorities are subject to certain restrictions. *The authorities may wish to remove these.*

The Isle of Man is alone among the Islands in having a policyholder protection scheme. The Jersey and Guernsey authorities have alternative trust arrangements which have been approved for the UK designated territory requirements.

None of the Islands has special legislation or supervision for pension schemes. The Isle of Man is developing such a regime. This will require considerable resources. *The regime should preferably be tested domestically before extension to the offshore market.*

*The Island authorities should give priority to ensuring that the supervisory regimes for longer term products, especially life assurance, are well-judged, effective and up to date. These are the products where the public are at risk. Within the captives area, supervision of third-party business should receive special priority.*

*The Jersey authorities need in my opinion to recruit a further well-qualified staff member with experience of insurance supervision to work alongside the present member. The insurance supervisors in Guernsey and Isle of Man both propose, rightly in my opinion, to add [one] additional analyst (net) to their staff.*

## 10 Companies

The Islands have developed large businesses as international company registration and administration centres. About 100,000 companies are incorporated in the Islands. Many more are administered from, but not incorporated in, the Islands.

The Islands' company sectors differ markedly from those of the onshore jurisdictions. Most companies are private companies formed by non-resident individuals or Trusts to hold assets of various kinds or business interests outside the Islands. Pyramid structures, with a Trust at the top owning a variety of companies, are common. As in other offshore centres, these companies have been a source of concern to the Island authorities because of the potential they offer for concealment of shady business

For multinational or overseas companies, the Islands' company vehicles may offer substantial advantages in tax savings and convenience. Such vehicles are used for purposes such as headquarters, treasury and international trading functions, captive and life insurance, collective investment, share option and pension funds, and leasing as well as other forms of asset holding.

Corporate service providers (CSPs), including company formation agents and managers, play a key role in the Islands. They are responsible for most company formations. They also provide Director, management, administration and company secretary services for many companies.

Company registration and regulation systems in the Islands are designed, as elsewhere, to give companies a legal identity and, if they so choose, limited liability; in return for making publicly available certain basic information about the Directors, owners, areas of activity and finances.

The regimes differ between the Islands and between the Islands and the UK. The authorities in Jersey and Guernsey, but not the Isle of Man, *vet* applications for new company registrations and require *confidential disclosure* to the authorities of the company's beneficial ownership. Unlike the Isle of Man and the UK, however, they have not in the past required *companies operating in or from the Islands but incorporated elsewhere* to register. In none of the Islands are limited companies required to file audited accounts or an *Annual Report* by the Directors. In the Isle of Man, there is a requirement to produce *audited accounts* but it is not enforced.

For the reasons explained in Chapter 10, *the case in favour of vetting is, in my opinion, strong*. As the Isle of Man authorities have found, there is great scope for abuse of offshore company vehicles to facilitate financial crime and money laundering.

*The case for requiring disclosure of beneficial ownership in confidence at registration, and changes subsequently, is likewise compelling.* The authorities need to know who the principals behind the businesses using the centre are.

*Companies administered or otherwise operating in the Islands, but incorporated elsewhere, should clearly be required to register and make confidential declarations of beneficial ownership in the same way as locally*

*incorporated companies.* The Jersey and Guernsey authorities are right to plan this change.

In my opinion, again, *there is a strong case for requiring all limited companies to prepare and file audited accounts, preferably as part of a wider initiative across all offshore centres.* Without this, the nature, scale and purpose of individual companies is likely to remain opaque. Non-trading, asset-holding companies as well as small companies could be permitted to file much abbreviated accounts. A requirement to *file* accounts, even a single-page summary, is much the best way to enforce the requirement to *keep* audited accounts.

The authorities' new policies for licensing and regulating company service providers (see section 13) should be seen as complementing, not replacing, the strengthened company regulation regimes.

Like other offshore centres, the Islands offer non-residents special company tax regimes designed to attract international business, notably tax exempt companies and international business companies. In recent G7 and OECD discussions, the industrial countries have suggested that this is harmful tax competition. This issue will have to be discussed at an international level. The Islands have made clear that they wish to play a full and constructive part in such discussions.

In the meantime, [Jersey has a special category of foreign registered investment companies which are subject to reduced regulatory requirements. *In my opinion, the same regulatory regime should apply to all companies associated with the Islands.*

*The Isle of Man has a special category of non-resident companies. These enable their owners to hide their identities and the activities of the company and to escape tax in return for an annual fee of £750. [The authorities are considering whether to abolish this category. I am sure they will be right to do so.]*

In my opinion, there is a presumption against permitting bearer shares. The Isle of Man and Jersey permit them. Guernsey does not.

*Jersey has modern procedures for dealing with bankruptcies and corporate insolvencies.. The Isle of Man procedures and some of the Guernsey procedures need updating. The authorities have proposals to tackle this.*

The authorities in all the Islands should introduce modern procedures enabling businesses to be rescued when appropriate, rather than made insolvent. Companies might be allowed to obtain a moratorium on action by creditors for (say) 28 days.

Guernsey and the Isle of Man should introduce a new public body with responsibility for carrying through the practical business of insolvency in public interest cases. The Official Receiver in England and the Viscount in Jersey offer possible models. The new body should preferably also have responsibility for ascertaining access to assets held in Trust and for licensing and supervision of insolvency practitioners.

Chapter 10 includes a checklist of further issues which the Island authorities should consider when updating their insolvency and bankruptcy regimes.

## 11 Directors and partnerships

As in the UK, the Islands' company legislation lays certain duties and obligations on Directors of companies. In my opinion such legislation needs to lay on Directors individually duties and responsibilities which cannot be ducked through general powers of attorney; to make provision for a Code of Conduct for Directors, preferably enforceable; to give the authorities wide powers, not confined to insolvency cases, to disqualify Directors; and to extend to Directors of companies operating on the Islands but not incorporated there.

The Islands have some, but not all, of this in place already. The forthcoming legislation on Trust and corporate services providers will provide an opportunity to improve the present provisions where necessary.

*The authorities need not only to have these powers but also to use them. Enforcement has so far been limited, possibly because of under-funding.*

The reputation of all the Islands has suffered from the presence on the islands, especially Sark of so-called “nominee” Directors of companies. These Directors know little or nothing about the companies they nominally direct. Owners of assets or business interests in other jurisdictions have found that they can combine secrecy and tax-free status by forming non-resident companies in (say) the Isle of Man with “Directors” (and hence residence for tax purposes) in (say) Sark (where there is no tax and no company regulation).

The authorities in Guernsey, Alderney and Sark are agreed that the problem must be solved by means of new legislation with application throughout the three Islands. The aim is to have this in place by the end of 1998.

Such legislation needs in my opinion to provide for the Guernsey FSC to license fit and proper all those in the Islands who serve as Directors or trustees by way of a business. It should also provide for *a Code of Conduct for Directors setting out the standards of conduct and diligence expected from them*. The FSC should have the power and the duty to enforce these requirements. Directors without a fit and proper track record and Directors who fail to comply with the Code of Conduct would have their licences withdrawn or not be licensed in the first place.

The Jersey authorities have introduced a framework for Limited Liability Partnerships. [In my opinion these should be subject to the same regulatory requirements as companies, including auditing and disclosure of accounts].

The Isle of Man offers a similar vehicle, somewhat confusingly called the “*Limited Liability Company*” (LLC). [The issues these raise are similar to those which arise on other companies in the Isle of Man].

## 12            *Trusts and Trustees*

Trusts are a key element in the Islands’ international finance centres. Trust and company vehicles taken together enable the Islands to offer a range of facilities not generally available in civilian law finance centres, offshore or onshore. The Islands are able to offer a favourable tax environment for both Trust and company vehicles..

For the most part, the Islands appear to have as good a legal framework for Trust; as any other jurisdictions, and better than most. The framework is broadly similar to that in the United Kingdom. In Jersey and Guernsey, however, Trust Law has since the 1980s had a mainly statutory basis.

*The Islands have rightly not followed other offshore centres in bringing in new legislation for STAR Trusts or so called Asset Protection Trusts. The Island Courts would be expected to set aside such Trusts*

Trust instruments offer great advantages. But the scope for abuses, both by settlers and by trustees, is also great. As Trusts age, moreover, the scope for abuses by trustees multiplies. Trustees should therefore be obliged to make proper disclosures to beneficiaries and to produce, submit and preserve audited accounts.

Professor David Hayton has identified a number of specific improvements that might be considered in the Islands’ Trust legislation. To counter potential abuses by settlers he has suggested provisions to reduce the scope of defending creditors, frustrating legitimate claims of heirs and spouses and implementing disreputable “flee” clauses.

To counter abuses by trustees, he has suggested that the legislation should ban sole trustees, oblige trustees to keep beneficiaries and representative objects of a power informed about the Trust; prohibit clauses exempting trustees and negligence of any kind; require waiver by future trustees of the privilege against self-incrimination and make Purpose Trusts subject to inspection by an official enforcer.

The Island authorities have no proposals to register or regulate Trusts as such But they do all propose to extend the regulatory boundary to include professional providers of Trust and trustee services. Legislation is to be introduced within the next [12] months, with a view to implementing the new regimes in 2000. *This legislation will offer a convenient opportunity to enact the other points mentioned below.*

*In my opinion, the Island authorities are entirely right to extend the regulatory boundary.* They are also right to focus the regulatory regime on Trust service providers rather than Trusts themselves.

The legislation should require the FSC to vet, license and regulate Trust Service providers and to promulgate enforceable Code of Conduct. The FSCs should have investigation and enforcement powers to refuse or revoke licences. It should be an offence to provide such services without registration. Chapter 12 includes illustrative sketches for the legislation and the Code

The transition from non-regulation to regulation will require careful handling. In my opinion, the initial registration process should set high standards and should be used to weed out dubious or incompetent providers.

The considerations that point to regulating Trust services providers in the Islands are equally cogent in the UK. Such a step would have the advantage of bringing for the first time a group of people inside the UK Government, or the Financial services Authority, with a clear responsibility for overseeing the Trust sector

### 13 Company and Trust services providers

*The Island authorities have all, rightly in my opinion, brought forward proposals to licence and regulate the providers of Trust and Company services. This is perhaps the only effective way to regulate the Islands' large Trust and company sectors.*

The objectives should be to protect the Islands' customers by preventing fraud and other disreputable activity by providers: to promote high standards of business conduct and competence, to combat abuse of the Islands' Trust and Company facilities for money-laundering or other forms of crime; to ensure that providers do not facilitate or acquiesce in such abuse; to put the bad providers out of business; and by all these means to protect the Islands' reputations.

The Islands' proposals envisage different legislative structures, regulatory coverage and frameworks, and timetables.

*A convenient structure is likely to be a single piece of overarching legislation, providing for the registration and regulation of all service providers, supported by specific rules or Codes of Conduct for each of the main areas, notably Trust services, company services, Director services and other specialist services.*

*In my opinion all Trusts and companies not licensed by the FSCs should be obliged to use a licensed provider. The authorities should set high standards from the outset and refuse to license questionable providers. The requirement for licensing should apply to all who provide Trust or Company services. There should be no exemptions for particular institutions, professional qualifications or small scale of activity. It should be an offence to act as a provider without being properly licensed Providers should be obliged to maintain adequate levels of PII and EFI.*

*The FSCs should have duties and powers to withdraw licences, attach conditions, impose fines, inspect and investigate, and police unlicensed business. They should be allowed to use their own staff or these purposes as well as outsiders.*

*Provision should be made for a serious but sensible measure of proactive enforcement, including some on-going inspection of the licensed population.*

*In the early stages at least the FSCs are likely to need between four and six staff carefully chosen, to introduce and implement the new regulation.*

The Islands have substantial numbers of resident lawyers and accountants to serve the heavy requirements of their international finance centres.

Those who provide Trust, company and investment services will be obliged to apply for licenses and submit to regulation just like other providers.

The Islands also apply appropriate professional disciplines to lawyers and accountants acting in other capacities. Lawyers are regulated by the Island Courts and/or Law Societies. Accountants are mostly regulated by the UK's accountancy bodies.

#### *14 Financial crime and money laundering: policy, legislation and achievements*

The authorities in all the Islands have made clear their firm commitment to prevent and combat crime of all kinds, wherever committed, including money laundering and tax evasion as well as drug trafficking, terrorism and fraud. They are committed to the fullest co-operation with other jurisdictions to that end.

All the Islands have a policy to comply with the Forty Recommendations on combating money laundering of the international Financial Action Task Force (FATF), revised in 1996

**The problems the Islands face in the field of financial crime** and money laundering are similar to those in other finance centres both offshore and onshore. Whether they have more than their fair share of money laundering and other financial crimes is hard to judge. Chapter 14 discusses this.

The Islands have developed considerable arsenals of legislation to combat financial crime and money laundering. They have generally followed UK models, sometimes with a considerable time-lag.

The UK's arsenal includes legislation relating to fraud, theft, extradition, proceeds of drug-trafficking and terrorist crimes, all crimes money laundering, police and criminal evidence (PACE), and international co-operation.

The Islands now either have all these elements in place or are will soon do so. The Isle of Man has all the main elements in place. Guernsey and Jersey plan to enact their *All Crimes Money Laundering* legislation in the autumn.

Jersey does not yet have *PACE*, or **International Co-operation Laws**. In the absence of these, the Jersey authorities do not **have** powers to obtain information and evidence, or to assist overseas authorities, except in cases related to drugs, terrorism and serious or complex frauds. They intend, however, to have these laws in place by the autumn of 1999. *It is clearly important that they should do so.*

For the most part, the Islands' existing and prospective legislation seems satisfactory. As in the UK, financial institutions and professionals in the Islands continue to have a common law duty of client confidentiality (though there are no banking secrecy laws). But the authorities have long had powers to override this duty in the pursuit of crime and the recent legislation has further enhanced their ability to do so.

There are, however, a few problem areas.

- *Locally indictable offences.* The new all crimes money laundering legislation in Guernsey and the Isle of Man follows the UK legislation in restricting cooperation with overseas authorities to cases where the predicate crimes would be indictable if committed in the home jurisdiction. *If the UK decides to drop this restriction, I hope that the Island authorities will do likewise.*

The Jersey authorities propose to restrict co-operation analogously to offences carrying a maximum sentence of not less than one year. **In** my opinion, this *restriction too should be dropped.*

*Co-operation thresholds.* The Jersey fraud legislation applies only to cases of of serious or complex" fraud. On this basis, the Jersey authorities have limited their co-operation with overseas authorities to cases involving £2 million or more, while sometimes being prepared to assist in smaller cases. In my opinion this threshold should be publicly scrapped.

- *Fiscal cases .* The Jersey authorities have also had a policy hitherto not to assist investigations by overseas authorities in purely fiscal cases, *I hope that they will be willing in future to give full assurance in such cases. The PACE and International Co-operation laws should be designed to provide the necessary powers. The sooner these laws can be enacted, clearly the better.*
- *Consent requirements.* The new all crimes money laundering legislation in the Isle of Man and Jersey requires the Attorney General's consent before the police can disclose information obtained through the suspicion reporting system to people outside the Island. This requirement could delay the transmission of urgent information. But the Attorney Generals propose in both cases to issue general consents.
- *Time-bars.* Jersey law requires that prosecutions of statutory offences must be brought within 3 years of the date when the alleged offences were committed. The *Jersey authorities are recommending to their Parliament,, rightly in my view, that all such time-bars to prosecution should be repealed. / Theft?]*

There are several areas, both in the UK and in the Islands, where the present legislation and international agreements might be improved so as to strengthen the hands of the authorities in the pursuit of financial crime and money laundering.

- *A general law on co-operation.* There may be a case for a single, general law on co—operation to replace the existing proliferation of differing provisions. Chapter 14 includes an illustrative sketch for such a law. *If the UK should think it right to adopt such a law, I hope that the Islands would follow suit.*
- *Information “gateways”.* The UK and the Islands have similar “gateways” for individual authorities to exchange information in the pursuit of crime. The most important lacuna seems to be the inability of Tax authorities to supply information to other authorities in the pursuit of crime. *If the UK is able to introduce such a gateway, I hope that the Islands will follow suit.*
- *Double Taxation Agreements (DTAs).* The combating of tax evasion, now a major problem for virtually all jurisdictions, depends importantly on exchange of information between tax authorities. Double Taxation Agreements (DTAs) between the UK and each of the Islands provide for such exchanges. But these dated and deficient Agreements prevent information exchanged from being used in evidence. *They should be replaced by either modern DTAs, based on the OECD model, or modern Exchange of information Agreements (EIAs) with comprehensive coverage in each case.*

In the UK and the Islands, financial crime remains too profitable. There are various steps that the authorities could consider to take the profits out of crime.

- *Unexplained life-styles.* There is a case for taking powers (as in the US and Ireland) to restrain assets, and reverse the burden of proof, in cases where people live beyond their visible means. *If the UK authorities decide to take such powers / hope that the Islauud authorities will follow suit.*
- *Penalties.* There is a case for *much higher financial penalties* for financial crimes. The penalties in the Islands are mostly similar to, or in some cases higher than, in the UK.
- *Use of civil law and locus.* In both the UK and the Islands, prosecuting authorities could probably use civil powers more extensively to take the profits out of crime and recover proceeds. *Legislation can provide a clear locus for public bodies to use such procedures.*

- *Licensing and disqualifying the service providers.* The licensing and regulation of Trust and company service providers in the Islands should contribute substantially to the prevention of financial crime.

## 15 *Financial crime and money laundering: practicalities*

The Island authorities have greatly improved their *intelligence* capabilities by introducing systems for suspicious transaction reporting along FATF and UK lines. In general these systems seem to work well. They have applied so far to suspicions of drug trafficking and terrorist offences. They will soon be extended to cover suspicions of crimes of all kinds, including tax evasion and other tax offences, as set out in the new all crimes money laundering legislation.

The obligation to make suspicion reports rightly extends, as in the UK, to all categories of financial institution, bureaux de change, Trust companies, other companies, lawyers, accountants, investment advisers and other partnerships and individuals.

Even ahead of introduction of the All Crimes Money Laundering legislation, the level of suspicion reporting has been impressive. The Island authorities received 1670 suspicion reports in 1997. The majority of reports have come from banks, though life insurance and Trust companies too have made significant numbers. *Other groups have made few reports and may not yet have adequate systems.*

The Guernsey and Isle of Man authorities feed all their suspicion reports into the NCIS database in London. *The Jersey authorities have in the past fed in only a limited number but propose to bring their practice into line with that of the other Islands.*

The Islands' police authorities have had some problems at the *investigation* stage, both when they have needed to make investigations themselves and when overseas authorities have asked them for help. The islands receive many more requests for help than they make themselves.

The main problem has been that the legislation has not hitherto provided the necessary powers. As discussed above, the Isle of Man authorities have now completed the legislative arsenal and the Guernsey authorities will shortly have done so. The Jersey authorities expect to have done so by the autumn of 1999.

In Jersey, the authorities' policies of not helping in fiscal cases and limiting assistance on fraud to cases above £2 million have been a further problem.

Some investigating authorities overseas seem still to believe that requests for assistance from the Islands have to be routed through the Home Office or the FCO. Their right *course is to make contact directly with the Island authorities.*

Some overseas authorities urged that their own investigators be allowed, in appropriate cases, to join the local investigators in making searches and conducting interviews. *The Island authorities are [all?] now willing to do this.*

For the most part, the Islands' procedures for obtaining *evidence* for overseas authorities have been less problematic. The traditional Letter of Request procedure seems to work well. Faster procedures are available in certain areas

Some problems have arisen when witnesses are reluctant to swear documents for use as evidence in the Courts of other jurisdictions. *The problem can, however, always be solved through the Letter of Request procedure.*

The Tax authorities in all the Islands have no general powers to collect information for the benefit of tax authorities in other jurisdictions. But they are prepared to obtain evidence for use in criminal proceedings in fiscal cases in the same way as for other categories of offences.



The UK's *Extradition Act 1989* applies directly to all three Islands.

When the new All Crimes Money Laundering legislation is in place, all three Islands will be able and willing to *trace, restrain and confiscate* proceeds of crimes of all kinds, including tax evasion, in response to requests from overseas authorities, within the limitations mentioned earlier. *In the Isle of Man, the proceeds in individual cases have (regrettably, in my opinion) to be at least £10,000.*

Where necessary, civil forfeiture procedures can be used as well. The Islands' Courts regularly issue Mareva restraint injunctions.

Where the Islands themselves are the lead-jurisdictions, they all have a policy to *prosecute* financial and other crime whenever there is sufficient evidence and a reasonable prospect of conviction.

The Island authorities have all made prosecutions relevant to the international finance centres over the years, though the numbers have been relatively small. Rates of conviction have been high.

The case which has attracted most attention in recent years is the Bank Cantrade case in Jersey (1998). Despite some criticisms, the authorities succeeded in obtaining two guilty verdicts and a partial guilty plea in a very complicated case. The authorities have noted for future reference the importance of bringing in specialist Counsel and forensic accountants from England at the earliest stage in cases of such size and complexity.

The Royal Court in Jersey has a policy to impose more severe sentences than in England. The Guernsey and Isle of Man Courts follow English sentencing practice.

## 16. Financial crime and money laundering: resources and structures

The authorities in all the Islands are firmly committed to providing the *resources* of judiciary, prosecution, law enforcement and intelligence necessary to police their international finance centres effectively.

*My impression is that, with rare exceptions in earlier times, the Island Judiciaries have been and remain well able to cope with the considerable workloads associated with the international finance centres. They bring in UK QCs in case of need.*

The Law Officers bear heavy burdens in all the Islands. *In my opinion, the Guernsey authorities would be well-advised to consider taking out two or three extra qualified staff and perhaps reducing their involvement in approving company registrations.*

In the police and Customs areas, the allocation of resources to fraud and commercial work, financial intelligence, investigations and responses to requests from other jurisdictions is of particular concern. Jersey now employs 11 people in these areas; Guernsey employs 8; the Isle of Man employs 6.5.

All the Islands will need extra resources to deal with the expected increase in suspicious transaction reports and confiscation orders after the new all crimes legislation and suspicion reporting take effect.

*Jersey and Guernsey have provisionally estimated a requirement for 2 extra staff. In my opinion, the Jersey force in particular is likely to need one or two more as well. The Isle of Man seems to have a special need for extra staff in this area. In my assessment, 4 extra staff are needed, in addition to filling the present vacancy, and an extra 2 staff for the all crimes suspicion reporting. The Head of the Fraud Squad should preferably be a full-time post as well.*

*In my opinion, the Islands would do well to develop new structures as well for policing their finance centres. The present Fraud Units and Joint Financial Investigation and Intelligence Units would best be brought together into single, self-standing, multidisciplinary *Financial Crime Units (FCUs)*.*

These units would be responsible for policing the Islands' finance centres and supporting the Attorney Generals in their roles as public prosecutors for the finance centres. The Director would report to the Attorney General, with a dotted reporting line to the Chief Constable

The Units would work in close co-operation with the Attorney General's office, the Police, Customs, the Tax departments and the financial regulators but be separate from them.

The Units would be financed separately from the Police and Customs. The Attorney Generals would be responsible for ensuring adequate budgets for policing and investigation of the finance centres

Staff would be able to make careers in this specialist area of work. They would no longer be obliged to move back and forth between this and other policing work

The suggested structure would differ from present UK structures. But the Islands, being small, have options that the UK does not have. The UK too, moreover, arguably needs a National Fraud Squad.

## 17 *International Standards*

The authorities in all the Islands accept that international standards of regulation, policing and co-operation are an absolute obligation.

They have understandably been concerned to obtain due credit for such standards. They have therefore sought to achieve accreditation or other forms of recognition from international bodies such as the FATF, the I3asle Committee, IOSCO and IAIS. In this there has been some progress, though less than one would wish.

In some areas, such as Trusts, there are no international bodies or forums that set and monitor standards. *The UK would be well placed to promote establishment of an international forum on Trusts.*

The Islands have also sought to obtain favourable treatment from the larger countries individually in recognition of their regulatory standards. Examples are designated territory status in insurance and investment. There is scope for the larger countries to extend such practices, in return for high standards of regulation and co-operation, especially in the fields of market access and tax enforcement.

The Islands have taken a leading role in seeking to promote high standards in the offshore generally. The Jersey authorities have been instrumental in developing the role of the Offshore Group of Banking Supervisors (OGBS) and in developing the Group's involvement in the FATF processes.

*There may be a case for replacing or supplementing the OGBS with a new structure comprising an Offshore Steering Group (OSG) at senior level, with a paid working Chairman and sub-committees for individual areas of regulation or policing.*

Also useful might be a forum for periodic discussions between representatives of the OSG and onshore jurisdictions including "parent" countries of offshore centres and other interested countries and international financial bodies. *The UK might be well-placed to convene such a forum.*

If no progress can be made in these areas, the UK, the Crown Dependencies and the British Overseas Territories could consider setting up a small independent *Financial Centres Audit Office (FCA O)*, somewhat along the lines of the Audit Commission in the UK. Such a body might help the offshore centres associated with the UK to achieve high standards, a level playing field and an enhanced reputation compared with other offshore centres. The better course, however, would be to develop international co-operation, accreditation and recognition.

For the most part, the infrastructures the Islands have developed for their international finance centres seem remarkably good for such small jurisdictions.

The Island authorities are all committed to implement the All Crimes Money Laundering regimes, to extend the regulatory boundary to encompass Trust and Company service providers, and to ensure adequate resourcing of the regulation and policing of their finance centres. They all need to consider the case for a financial services ombudsman.

In other areas, the requirements vary from Island to island.

*In Jersey, the authorities most urgent requirement, in my opinion, is to reach a position where they can and do co-operate fully with other countries in their combating of crime of all kinds, including tax evasion and lesser frauds, not least at the investigation stage. This will require a new policy stance and early passage of the missing elements in the legislative arsenal. Several aspects of financial regulation, notably insurance, need to be developed and deepened. Customer protection schemes need to be considered. Companies operating but not incorporated in the Island need to be registered.*

*In Guernsey, an urgent requirement, which the authorities are already tackling, is the proposed legislation and regulation to deal with the problem of bogus Directors and the "Sark Lark's The Law Officers and legal draftsmen need more staff. As in Jersey, companies operating but not incorporated in the Island need to be registered. The insolvency legislation needs to be updated. Certain aspects of financial regulation need to be developed further. Customer protection schemes need to be considered.*

In the Isle of Man, the urgent requirement is to strengthen regulation of the Island's large company sector and its considerable population of company and Trust service providers. New insolvency legislation is needed and the Island's Trust law needs attention. Extra resources are needed in certain areas of regulation, notably banking and investment supervision. The police need more resources to combat fraud and money laundering.

*The Report has identified needs for around 20 extra professional staff in each Island (to police and regulate the international finance centres (see Box 18.1). It should be possible to meet some of the requirement by redeployments from elsewhere.*

*Chapter 18 includes a suggested action timetable (see Box 18.2). Under this, the Islands would have implemented by the end of 2000 all the legislative and policy changes discussed in the Report except those contingent on prior action by the UK*

#### BOX 18.1 STAFF REQUIREMENTS INDICATED BY THE REPORT

##### **Increase in full-time equivalents, gross**

	<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of Man</i>
Support for Law Officers		2	
Police and other staff for Fraud and Financial Intelligence and Information Units (FFIIUs)		3	7
Registration of Companies not locally incorporated, returns of beneficial ownership, filing of accounting information, enforcement	3	3	3
Regulation of banks, investment business & Stock Exchange	3	3	4

Regulation of insurance	1	1	1
Regulation of Trust and Company service providers	5	4	5.5
Enforcement	3	1	
Customer protection and support to 1 Ombudsman		1	0.5
Support staff		1	
	20	18	20

BOX 18.2  
TIMETABLE FOR IMPLEMENTATION

\*Requires no legislation or only minor legislation.

\*\*Requires major primary legislation or treaty

<i>Date and measures</i>		<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of Man</i>
<b>1998</b>				
Conflicts of interest	*	*	*	
All Crimes Money Laundering	**	**		
Removal of prosecution time-bar	*			
Financial crimestoppers line		*	*	*
<i>1999</i>				
PACE law	**			
International Co-operation law	**			
Removal of fraud & ACML threshold		*		
Regulation of <i>Director</i> services		**		
Changes to Law on Purpose Trusts			**	
Insurance Law & regulation changes	**	**	**	
FSC and Regulatory changes, inc Board and structural changes, on-site inspections and staff recruitment	*	*	*	
Company regulation changes, inc action on beneficial ownership and non-resident companies (IoM), registration of companies incorporated elsewhere (J,G) & LLPs disclosure regime (J)	**	**	**	
Insolvency legislation	*	**	**	
New Double Taxation or Exchange of Information Agreements	**	**	**	
Establishment of separately financed FCUs.				
Complete recruitment of new staff for FCUs, FSCs & Law Officers	*	*	*	
<i>/999 or 2000</i>				
Improve Trusts legislation	**		**	**
Licensing & Regulation of Trust and Company Service providers			**	**
Customer Protection schemes	**		**	**
Financial Services Ombudsman	**		**	**
Investment business legislation changes	*		*	*
Rules of financial business conduct	*		*	*
Finance centre training	*			*

*TIMING CONTINGENT ON UK ACTION*

Remove ACML indictable offences limitation  
General law on co-operation, gateways etc\*\*  
Measures to take profits out of crime: \*\*  
unexplained life-styles / use of civil law powers

\* \* \*  
\*\* \*\*  
\*\* \*\*

# REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES

## PART I

By Andrew Edwards

### INTRODUCTION

#### 1.1 *Terms of reference*

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

For the reasons discussed in chapter 4, the three Islands are collectively known as Dependencies of the British Crown, or “Crown Dependencies”. The responsibilities of the Guernsey authorities extend in many (but not all) areas to the Islands of Alderney and Sark as well as Guernsey itself. With the agreement of all the authorities concerned, therefore, I have included Alderney and Sark within the Review.

#### 1.2 *Plan of report*

This Report presents the outcome of the review. It consists of four parts.

Part I presents my own assessment. This reflects extensive discussion with the authorities and practitioners in the Islands and in London and some discussion with officials in other financial centres. I myself, however, take responsibility for what the report says and for any errors of fact or judgement that it may contain.

Parts II, III and IV are “Island Chapters” for Jersey, Guernsey and the Isle of Man respectively. The Island authorities have prepared these in close consultation with me.

The Island Chapters offer professional prospectuses for the finance centres of each of the Islands. They are designed to provide for each Island, within a manageable compass, reasonably full descriptions of their political and judicial systems, their economies and finance industries, and their laws, systems and practices for financial regulation, company regulation, the pursuit of financial crime and co-operation with other Jurisdictions.

I hope that the Prospectuses will be of value to international institutions, Governments, judiciaries, regulators, law enforcement agencies and financial and legal practitioners inside and outside the Islands. I hope, too, that the Island authorities will be willing to update them each year so that they may be of continuing value.

I would like to think that other Offshore Finance Centres, too, where information is often not available in a handy form, may likewise be willing to prepare and keep up to date professional prospectuses of a similar kind, designed for similar audiences.

#### 1.3 *Review Team*

The subject matter of the Review has called for a variety of professional skills and experience.

I am therefore grateful to Mr Munro Sutherland, Mr Guy Sears and Mr Derek Sullivan, who have looked at banking, investment and securities, and insurance and pensions supervision, respectively, in the Islands, and

to Professor David Hayton, who has looked at various aspects of Trusts in the Islands. The main conclusions from their work are reflected in the report.

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

#### *1.4 Participation and Consultation*

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

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

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

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

I have drawn heavily on advice from professionals and regulators with knowledge and experience of other “Offshore” centres, notably Gibraltar and the Caribbean

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

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

## 2 THE ISLANDS’ FINANCE INDUSTRIES

### *2.1 Overview*

The development of the Islands’ finance centres over the past 30 or 40 years, and especially over the past 20 years, has been a remarkable success story. They have been considerable players in the wider development of “Offshore” centres over this period.

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

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

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

### *2.2 Offshore centres generally*



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

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

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

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

similar small centres which are coastal or inland enclaves;

special tax and/or regulation zones established by larger countries within their own borders;

*any* finance centre, including the large world centres, with a large volume of non-resident clients.

As international trade, multi-national companies and holdings of personal wealth have grown, and exchange controls have progressively been dismantled, so offshore business in the widest sense has burgeoned at rates outstripping the growth of national incomes. It is estimated that one-third of the wealth of the world’s “high net worth individuals”, or approaching \$6 trillion out of some \$17.5 trillion, may now be held “offshore”: that is, outside the Jurisdictions where the individuals live. (Merrill Lynch & Gemini Consulting, World Wealth Report, 1998). The Crown Dependencies probably have between 5 and 10 per cent of this market.

### 2.3 *Development of business in the Islands*

The Crown Dependencies themselves, and the Channel Islands in particular, have attracted a certain volume of tax-driven business for several generations.

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

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

### 2.4 *Nature of business*

The Islands now have a wide range of finance business, including banking, investment, insurance, company business and trust business.

Total bank deposits in the Islands (resident and non-resident) are currently around £163 billion (Jersey £49 billion, Guernsey £4 billion, Isle of Man £10 billion). For comparison, non-resident deposits held in the UK are around £ 1,000 billion.

Total funds under management are £...billion (Jersey £..., Guernsey £17 billion (collective investment schemes only), Isle of Man £16 billion. (For comparison, total non-resident funds under management in the UK are £...billion.)

Insurance companies in the Islands have total assets of £...billion (Jersey , Guernsey €6.5 billion, Isle of Man £7 billion). Guernsey has 10 authorised life assurance companies. The Isle of Man has 15. Guernsey has [475] captive insurers. The Isle of Man has 167.

Apart from unit trusts, no figures are available for the number of trusts or the value of assets held in trusts established on the Islands. The amounts held in this way are, however, believed to be very large, especially in Jersey but also in Guernsey (where a recent survey indicated that they were likely to be at least two-thirds as large as bank deposits). Assets held in trusts will be reflected in part, but only in part, in the bank deposit and assets under management figures quoted above.

Around [100] thousand companies are incorporated in the Islands. Jersey has some 40,000 some 24,000 of them tax exempt or subject to special non-resident tax regimes. The corresponding figures for Guernsey are [16,000] and 8,000. The corresponding figures for the Isle of Man are 42,000 and [21,000].

The table at Box 1 includes some of the figures just mentioned, along with similar figures for a selection of other offshore centres.

### 2.5 *Country distribution of Financial Institutions*

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

Although UK parentage still predominates, the parent institutions now come from a wide variety of other countries as well, as indicated in Box 2.

### 2.6 *Country distribution of customers*

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

In earlier times, the Islands' finance business was heavily UK-oriented. Although the UK the most important single client, however, the business has grown to be genuinely international. The Islands' customers now come from all areas of the world.

UK customers account for only ....per cent of total bank deposits in Jersey. The corresponding figure in Guernsey is 14.5 per cent and in the Isle of Man 25 per cent.

The banks do however continue to invest a high proportion of their deposits in the UK. In Jersey, the percentage is ..... per cent; in Guernsey, 41 per cent; and in the Isle of Man, 53 per cent. There is thus a substantial net inflow of funds to the UK, amounting to around [25] per cent of total deposits held in the Islands.

In terms of currencies, sterling deposits now account for only some ...per cent of the total (Jersey), 34 per cent (Guernsey) and ... per cent (Isle of Man). [Business denominated in other European currencies is now as large as US dollar business. See Box 3.]

### 2.7 *Reasons for business*

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

The substantial independence of the Islands has enabled them above all, like other offshore finance centres, to offer potential customers *tax advantages* which the large centres themselves and islands without such independence cannot readily emulate. These ' advantages turn importantly on maintaining low levels of public

expenditure in relation to GDP, as the Islands have done.

The extent of the tax advantages to particular customers depends in practice on a wide range of factors, not least the tax rules in customers' home countries or the other countries where they operate.

For some individual customers, however, and above all for expatriates, the low rates of direct tax (20 per cent on personal and corporate incomes in all three Islands), the absence of inheritance, wealth or capital gains taxes, and the non-taxation of interest paid to non-residents may add up to a highly favourable tax environment.

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

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

- A good reputation
- Political stability
- Good links with other respected Jurisdictions
- An absence of corruption
- Confidentiality
- Good laws, preferably familiar from elsewhere
- Good systems of justice and public prosecution
- Good law enforcement
- Good counter-crime and money laundering regimes
- Good financial and company regulation, preferably familiar from elsewhere
- Good and honest financial institutions, including major world names
- Good company and trust vehicles, preferably familiar from elsewhere
- Good and honest professional and supporting services at reasonable cost
- A familiar local currency
- A familiar language
- Good communications

The continuing growth of the Crown Dependencies' financial business in recent years indicates the considerable success they have achieved in these areas as well. The islands' links with the British Crown and the UK, including the interlocking of legal and judicial systems and the close copying of UK legislation and regulation alongside their traditional independence in fiscal affairs, have encouraged perceptions that they combine key advantages of the UK and the "Offshore". They are even sometimes known as "Offshore UK".

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

## 2.8 *Living standards*

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

In Jersey and Guernsey, GDP per head [was slightly below that of the UK in 1980; the Guernsey chapter looks wrong on this] but is now about 25 per cent higher in Jersey and about 20 per cent higher in Guernsey than in the UK. This comparison probably overstates the margin of difference since prices are mostly somewhat higher than in the UK as well.

In the Isle of Man, GDP per head has risen from 57 per cent of the UK level in 1985 to around 80 per cent now.

### 2.9 *Dependence on finance business*

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

### 2.10 *Differences between Islands*

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

Jersey has the largest banking, trust [and investment business] sectors but a relatively young insurance sector.

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

The Isle of Man has the largest life assurance sector and an investment sector similar in size to Guernsey's but smaller banking [and trust] sectors. The Island also has a significant shipping sector (not further discussed in this report).

The table at Box 4 shows the numbers of people employed in the banking, investment and insurance sectors of each of the Islands.

### 2.11 *Comparison with certain other "Offshore" centres*

The Crown Dependencies have [larger populations and somewhat more business than Gibraltar and most of the British Caribbean Territories]. Compared with Hong Kong and Singapore, on the other hand, they are relatively small. The Box I table gives some comparisons for selected centres.

### 2.12 *Prospects for future growth*

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

With total populations of some 85,000 and 59,000 respectively, population densities are already high, much higher than in the UK (1600 and 2250 per square mile, respectively, as against 600 in the UK). High proportions of the working populations in the Islands, x and y respectively, are already working in the finance industries or supporting services. For some years now, the Islands have been obliged to limit severely, through residence or housing permits, the inflow of newcomers to the Island.

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

The alternative to such expansion will be to reinforce the existing policy of rigorous selection. The Islands will have to choose what financial business they do and do not want.

The Isle of Man, with 73,000 people, is less densely populated. Its population density, 275 per square mile, is about half that of the UK. In addition, a lower proportion of the total population is employed in the finance industry and supporting services. The scope for expansion of the finance industry is correspondingly much greater. But the Island authorities have a policy to avoid undue reliance on any single industry and may be reluctant to see the Island's population density rise too far.

## 2.13 Vulnerabilities

The potential risks to the Islands' finance centres are the same as *for* other offshore finance centres. They come partly from outside and partly from inside.

From outside, the main risk is that the large countries where most of the Islands' customers live or conduct business will change their tax laws, regulations or enforcement practices in ways which make the facilities of offshore centres seem less attractive. The large countries might seek to introduce new international tax standards or conventions:

the on-going discussions in the G8, the OECD and the EU are addressing these matters. Or they might individually make further changes in their tax regimes, as they have done in the past. Or they might sharpen their enforcement practices. It seems likely, however, that such measures would lead to changes in the mix of business of offshore centres rather than put them out of business altogether.

Re-introduction of exchange controls could likewise have major effects on offshore centres. Fortunately, however, such a development looks improbable.

Changes in regulatory standards in the larger countries, such as capital and reserve requirements or conditions for marketing financial services in these countries, could have some impact as well. ..

From inside, the main risk is a loss of reputation. Offshore finance centres, even more than the large onshore centres, live by their reputations. Their problems, real or perceived, tend to receive disproportionate coverage in the world's Press.

The reputations of any finance centre may suffer as a result either of genuine problems or of misinterpretations. Genuine problems may include corruption, crime or perceived failures of legal processes or regulation, and the associated public scandals. The laws, regulations and systems discussed in this report are largely concerned with minimising the likelihood of such problems.

Also important are perceptions of confidentiality. Some customers of the Islands would move their business elsewhere if they felt that their affairs would not remain confidential.

Misinterpretations may be troublesome as well. All too often the successes of offshore centres, notably in the fight against international crime and money-laundering, are misinterpreted as indicating a prevalence of criminal activity rather than effective counter-crime systems. The Islands seek to minimise such risks through careful and timely briefing.

Among other internal risks, three are especially worthy of mention. As discussed above, the Islands could have difficulty in providing skilled staff and professional and support services to sustain ever-increasing amounts of business. They could also lose much of their comparative advantage, compared with the large countries, if they should ever allow public expenditure and taxes to rise to levels familiar in the larger countries or if local wage costs should ever become significantly uncompetitive.

## 2.14 International criticisms

It is sometimes argued, especially in the world's large Jurisdictions, that offshore finance centres should not exist at all. The British Crown the UK are sometimes criticised for being associated with such Jurisdictions.

Whatever view one may take on these matters, there are two points from the preceding discussion that should be borne in mind.

First, the British offshore finance centres are a direct result of the fact that they have internal self-government. As discussed earlier, this has been the key factor in enabling such territories to develop financial centres. Especially, perhaps, in the Crown Dependencies, the development of such centres has been

the product of local initiatives pursued within a constitutional tradition of independence in domestic matters.

Second, the low rates of direct taxation which have helped the Crown Dependencies and other offshore centres to succeed in the way they have reflected, in part at least, the low proportions of public expenditure to GDP in the centres.

## REVISED SECTION

### 2.14 Criticisms and defences of the offshore

Offshore finance centres as a group have attracted considerable criticism in recent years. It is sometimes argued, especially in the large jurisdictions, that they serve no useful purpose and should not exist at all. The centres themselves argue, on the **contrary**, that they contribute significantly and constructively to the world's financial system.

The critics usually target three main features of the centres

the *tax regimes*, which are often seen as inducing particular industries to **choose** unsuitable offshore locations at the expense of the onshore jurisdictions and as depriving onshore jurisdictions of tax revenues properly due to them,

a framework of *secrecy, allied to poor co-operation* with other countries, which attracts and facilitates disreputable business and money laundering and

*poor regulation*, which enables financial institutions to build businesses the back of low standards, with considerable risks to clients.

Later chapters of the report suggest that the second and third criticisms, if applied to the Crown Dependencies, would be quite wide of the mark. For the most part, the position in these Islands is quite the opposite of what such criticisms would imply.

The report does not offer any assessment of the Islands' tax regimes. The tax regimes of offshore centres generally, and indeed of onshore centres, are the subject of on-going discussion in the G7, the OECD and the EU. The offshore centres themselves argue that onshore centres, too, are active in seeking to attract business through favourable tax regimes.

The case in favour of offshore centres, from a global perspective, includes a number of elements

*The right to supply services.* There are many quality services to customers that well-regulated offshore centres are well able to supply and have a perfect right to supply like anyone else. Examples are Trust services and services to expatriates

**Stability.** Stability is an advantage that offshore centres may be able to offer. In the Crown Dependencies, systems of Government have remained remarkably stable over many centuries. Rates of tax on personal and corporate incomes have remained unchanged, at 20 per cent, for nearly half a century



	<b>61.9</b>								
Dollars \$bn .									
<b>Funds under management £bn</b>	<b>37.8</b> <b>£fl.4bn</b>	~					—	—	
<b>Insurance assets held</b>									
<b>Companies locally incorporated, '000</b>	<b>32</b> <b>17,000</b>								
<b>Q/w:</b>									
<b>Normal tax</b>									
<b>Special tax or no tax</b>	<b>15,000</b>								

BOX2

PARENTAGE OF THE ISLANDS' FINANCIAL INSTITUTIONS

Per cent of total institutions, end 1997

<i>Banks etc</i>	44	
	20	je. 100%
UK	8	(% are for
Other EU	15	banking
Other Europe	4	institutions
N America	9	only)
South Africa	0	
Other overseas		
Local		

	Jersey	Guernsey	Isle of Man
<i>Investment institutions</i>	30.0	100% (Inv	
	12.5	institutions	
UK	9.5	only)	
Other EU	12.5		
Other Europe	8.0		
N America	12.5		
South Africa	15.0		
Other overseas			
Local			
<b>Insurance companies</b>	21%	100%	
	14	(Insurance	
UK	7	companies	



<b>Other EU</b>	30	only)	
<b>Other Europe</b>	21		
<b>N America</b>	-		
<b>South Africa</b>			
<b>Other overseas</b>			
<b>Local</b>	7		

### BOX3

#### CUSTOMERS OF THE ISLANDS' FINANCIAL BUSINESS

Percentages of total business originating from the areas listed or denominated in the currencies listed.

Jersey	Guernsey	Isle of Man
<i>Bank deposits</i>		
UK	15	
Other EU	8	
Other Europe	32	
N America	4	100%
South Africa	-	
Other overseas	26	
Local	15	
UK £	32.0	
US\$	42.0	
DM	7.5	
FF	0.7	100%
Other European Yen	62	
	0.3	
Other	11.3	
<i>Funds under Management</i>		
UK	4	
Other EU	These figures are unavailable	
Other Europe		
N America		
South Africa		
Other overseas		
Local		
<i>Insurance premium Income</i>		
UK	10.5	
Other EU	3.0	
Other Europe	3.3	
N America	17.2	100%
South Africa	56.0	
Other overseas	-	
Local	10.0	

### BOX4 NUMBERS EMPLOYED IN THE FINANCE SECTORS

	Jersey	

TOTAL	7134	t 996	I 8130

	Full time	Part time	Total
Banks	4562	585	5147
Other deposit takers investment and securities business	145	25	170
Insurance and pensions			
	1612	249	1861
	411	70	481
Company, Trust and Advisory services	404	67	471

### 3 THE ISLANDS' REPUTATIONS

#### 3.1 *The Islands' reputations*

In my extensive discussions with professionals of wide experience inside and outside the Islands, I found widespread agreement that the Islands are in the top division of small-to-medium-size offshore financial centres.

Many of the professionals I met expressed their admiration for what the Islands had achieved in recent decades.

Many of them commended the standards of government, regulation and business in the Islands and the absence of corruption.

Many of them noted, too, that the Islands are full of able and helpful people, who co-operate well with the rest of the world.

The Islands' co-operation with other Jurisdictions in the pursuit of drug-trafficking and terrorist offences won universal praise.

### *3.2 Some concerns expressed*

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

I do not regard such concerns as surprising or ominous. All financial centres, onshore and offshore, have problems. All have their critics. The Islands are no exception.

I have, however, thought it important to evaluate such concerns carefully, in so far as they are relevant to the Islands as international finance centres, and to consider what is to be learned from them.

The concerns most frequently expressed related to some perceived conflicts of function and interest, especially among the authorities but also within the financial and professional sectors; a perceived absence of any realistic means of redress (short of extended Court processes) for customers in dispute with institutions or professionals in the Islands; the perceived continuation in business of firms or individuals with questionable track records; fears that too little was known about many of the companies operating in the Islands; anxieties about the activities of certain Island Directors of companies incorporated elsewhere; fears that the Islands' activities were depriving other countries of tax revenues; and a belief that some Island professionals, in collaboration with colleagues in other Jurisdictions, were facilitating tax evasion and other forms of financial crime

Some of these concerns seemed to be widely shared. Others seemed to be minority views, sometimes confined to one or two Islands, but strongly held.

Some officials, regulators, investigators and prosecutors outside the Islands, while mostly full of praise for the Island authorities, felt that they could sometimes have co-

operated more effectively in the pursuit of crime. In many cases, the problem seemed to lie in the absence of the necessary statutory powers rather than unwillingness to help. In others, the problem seemed to lie in failures of communication or understanding.

As discussed above, I do not think that these expressions of concern should be regarded as especially ominous. If officials, professionals and others had been invited to contribute their views to a similar review of other international finance centres, the concerns expressed would probably have been at least equally serious. I have however discussed them carefully with the Island authorities, and these discussions have influenced the report's conclusions.

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

## **4 OBJECTIVES**

#### *4.1 Objectives*

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

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

The adoption (or re-inforcement) of such standards may sometimes entail some initial loss of business, especially less reputable business. As many professionals have remarked, however, the Islands' best interests must lie in developing good business and rejecting business which is questionable or worse, especially as there is more than enough good business to keep the Islands occupied. In the medium and longer term, moreover, high standards will encourage, not discourage, the growth of business.

[I am pleased to say that the Island authorities have confirmed that the policies they have for developing their finance centres correspond exactly to the approach suggested above.]

#### *4.2 Practical implications*

##### ***I***

Fulfilment of the proposed objective will depend on developing or maintaining high standards in a number of areas:

*public policies* and administration;

*legal, judicial and prosecution* systems;

the avoidance of *conflicts of interest*;

the constitution of *regulatory authorities*;

the legislation, systems and practices for licensing and regulation of *financial institutions*, including co-operation with other countries in the pursuit of regulatory offences;

the legislation, systems and practices for registering and regulation of *companies, resident and non-resident*, and for dealing with insolvency;



the common and statutory law for *Trusts* and *Trustees*;

the licensing and regulation of *professional service providers*, including *company formation agents*, *providers of Director services* and *other providers of corporate, trust and investment services*;

the laws, systems and practices for *countering crime* of all kinds, including money laundering and tax evasion as well as drug trafficking, terrorism and fraud; and

*co-operation with other countries* in the pursuit of crime of all kinds.

To ensure the continuing achievement of high standards in an ever-changing world, and the receiving of credit where credit is due, there is a strong case for encouraging the development of effective international auditing and accreditation of legal, regulatory and counter-crime systems and practices in all the world's finance centres. I hope that the Islands will continue to be active in this area as well.

The remaining sections of the report deal in turn with each of the areas listed, some briefly, others at greater length.

## **5 SOME ASPECTS OF GOVERNMENT**

### *5.1 Introduction*

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

### *5.2 Political stability*

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

Domestically, the Islands have likewise maintained their political systems, with only limited changes, over many centuries.

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

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

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

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

Fourth, the Island's Chief Judges, known as the Bailiff and Deputy Bailiff, act as Speaker and Deputy Speaker of the Parliaments and also as first citizens and spokesmen of the Islands.

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

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

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

Although similar in most respects to the Channel Islands, the Island's domestic political system more closely resembles those of the larger countries in two respects:

First, the legislature and the executive are more separate. The Island has a Chief Minister, who acts as First Citizen and chief spokesman for the Island, and a Council of Ministers.

Second, the Speaker is not the Chief Justice of the Island but [is elected by the Island's Parliament]. The Judiciary play no role in the legislative or executive processes.

The Lieutenant Governor is able, moreover, to approve some categories of domestic legislation under powers delegated by the Crown.

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

In my assessment, the intertwining of the legislature and the executive, especially in the Channel Islands, has not so far been a problem in terms of internal governance or external perceptions of the Island as a finance centre.

### 5.3 *Relations with European Union*

When the UK joined the European Union, the Islands decided not to become full members. Under Protocol 3 of the Treaty of Accession, however, they are treated as

part of the EU for Customs purposes and for certain aspects of the common agricultural policy. There is consequently free movement of goods between the Islands and the EU countries

## REVISED SECTION

### *5.3 Relations with European Union*

When the UK joined the European Union in 1973, the Islands decided not to become full members

The main considerations at the time were

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

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

In the Channel Islands, there were concerns that the requirements foreseen for harmonisation of VAT and Excise duties would damage the tourist trade

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

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

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

Under Protocol 3 of the UK's Treaty of Accession, therefore, the Islands are treated as part of the EU for Customs purposes and for trade in agricultural commodities, but not for other purposes. The authorities have opted in practice, nevertheless, to follow many aspects of EU legislation and standards in order to promote their business with EU countries.

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

#### 5.4 Public Policy and administration

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

#### 5.5 *Legislative processes*

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

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



## 5.6 *Legal systems*

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

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

## 5.7 *Judiciary*

The Islands' judicial systems have to deal with substantial amounts of business arising from the international finance centres.

The local structures, more fully described in the Island Chapters, differ in certain respects from those in England. The British Crown, however, makes the senior appointments and the Appeal procedures mainly involve UK judges and lawyers.

In *Jersey and Guernsey*, there are (separate) Royal Courts which hear all criminal cases and the most important civil cases involving the international financial centre. The presiding judges of law are the Bailiff or Deputy Bailiff both appointed by the British Crown after consultation with the Island authorities, or other Judges appointed by the Bailiffs. In addition, there are twelve judges of fact, called Jurats, Elected by an Electoral College, Jurats are somewhat similar to Justices of the Peace in England. The Bailiff or Deputy Bailiff sit with two or more Jurats.

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

The other main difference, compared with England, is that (as discussed earlier) the Bailiff serves as Speaker of the Island's Parliament and as First Citizen and spokesman of the Island as well as being the Island's Chief Judge. The Deputy Bailiff,

similarly, serves as Deputy Speaker. Some of my correspondents argued for separating these roles, especially in a world where judicial review is now more common, so as to put beyond doubt, in the perception as well as the reality, the independence of the Judiciary from the Legislature. The States of Jersey came close to doing so in [1992]. This, however, is a constitutional issue which lies beyond the scope of the present report.

The *Isle of Man's* judicial system is closer to the English system. The Island's High Court hears all civil matters and another Court equivalent to an English Crown Court hears serious criminal cases, including financial and fiscal cases. The Judges presiding over both Courts, known as First and Second Deemsters, are appointed by the British Crown. In serious cases, [both civil and criminal?], the presiding Deemster is accompanied by a jury of seven. The Deemsters do not serve as Speakers of the Island's Parliament or as First Citizens and are clearly independent of the Legislature and the Executive.

For *all the Islands*, the First Court of Appeal consist of the Chief Judges of each Island and English, Scottish and Northern Irish QCs appointed by the Home Secretary after due consultation. The final Court of Appeal is the Judicial Committee of the Privy Council in London.

### 5.8 *Prosecution*

Each of the Islands has an Attorney General (known in Guernsey as HIM Procureur) who acts as public prosecutor. In Jersey and Guernsey the Attorney Generals have Deputies known as Solicitor General and Controller General, respectively There are supporting

The Attorney Generals and their Deputies are appointed by the British Crown, after due consultation, to serve as independent public prosecutors. They combine this role with the two further roles of advising the Crown and the Island Parliaments on legal matters (including oversight of legislation drafting) and authorising various actions by the police and others under fraud, money laundering and other criminal legislation. [In Guernsey they also authorise company formations]. They do not undertake any private work.

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

A few of my correspondents argued that the role of public prosecutor should not be combined with that of adviser to an Island's Parliament. For example, they thought

it wrong that the same person should *both* advise the Parliament or the Executive on legal aspects of their relations with someone *and* be responsible for the decision whether to prosecute him.

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

### 5.9 *Resources*

As in other Jurisdictions, the Islands appear to have had workload problems from time to time which have led to some delays in prosecutions, trial verdicts and responses to requests for assistance by other Jurisdictions, and to backlogs in law drafting.

The Island authorities recognise that in an international finance centre it is more than usually important to avoid delays and backlogs of this kind. They have told me that an on-going solution needs to contain a number of elements:

First, *staffing*. They will need to ensure that sufficient staff with the necessary skills are available, not least for law drafting. Especially in the Channel Islands this is likely to require some long term planning for as long as legal training in Normandy is deemed a necessary part of the training programme for Island lawyers.

Second, *delegation*. The Attorney General and his Deputy propose to analyse carefully what work they must do themselves and what they can delegate to supporting staff or to other parts of the Government or Regulatory regime.

Third, *outsourcing*. They will need to buy in expert resources from outside to deal with peaks of workload and preferably to establish a pool of experts for this purpose.

In my opinion, this is entirely the right approach.

#### 5.10 *Conflicts of interest*

One of the features that most distinguishes the best offshore finance centres from lesser centres is the avoidance of corruption and abuses arising from conflicts of

interest. The Crown Dependencies have been keenly conscious of the need to avoid such abuses and have shown great determination in developing rules and procedures accordingly. These rules and procedures have, moreover, been considerably tightened in recent times.

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

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

The Crown Dependencies have tackled the problem with considerable success by developing a culture of transparency coupled with good sense. Members of the Island Parliaments are allowed to retain commercial and professional interests. But:

they are obliged to record their interests in a public register, including employment, Directorships and investments where their interest exceeds 10 per cent; and

they habitually declare any relevant interests orally before participating in the discussion of any matter.

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

In addition to the disclosure regimes, the Islands (have either introduced or are considering the introduction of) certain further elements of good practice for Members of the Island Parliaments:

an obligation that Members should not only declare their interests but also withdraw from meetings of the Parliament or any of its



Committees when they have (or might reasonably be perceived to have) a financial interest in the matter under discussion;

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

a general presumption against accepting or retaining Directorships of companies, especially financial institutions, directly involved in or affected by the Ministries or Parliamentary Committees on which they serve or have recently served.

In my opinion, the Islands will be right to include these elements in their Codes of practice where they do not do so already. As discussed above, dealing visibly and effectively with conflict of interest problems is important for international finance centres not just in itself but also in terms of confidence and reputation.

It may be necessary to accept the corollary that the leading politicians, in particular, should be paid more for the public duties they discharge.

The Islands apply much the same principles and practices to the *Financial Services Commissioners* who oversee the independent regulatory authorities for the financial services industries. In this case, however, they quite often appoint people still active in the finance industries or the related professions on the basis that the regulatory authorities will benefit from the well-informed contributions such people can make to the conduct of financial regulation. In my opinion this approach is entirely justified provided that there is scrupulous observance of the other principles set out above.

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

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

In the *private sector*, too, there is considerable scope for conflicts of interest, not least in relation to auditing functions and client services. The Islands' professional practices have, however, mostly split off their audit work from their Trust and other

work. In addition, the Islands' proposals to regulate the provision of corporate and trust services will help to identify and prevent other potential conflicts.

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

## **6 FINANCIAL REGULATION OBJECTIVES, STRUCTURES AND COVERAGE**

### **6.1 Objectives**

All the Island Parliaments have set firm objectives to have well regulated finance centres

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

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

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

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

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

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

## *6.2 Parliamentary Committees and Government Departments*

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

The *Isle of Man* Parliament set up an independent Financial Services Commission (FSC) in 1983, as part of its response to the Savings and Investment Bank collapse in 1982.

The regulation of Insurance and Pensions was hived off in 1986 to a separate Insurance and Pensions Authority (WA).

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

In *Jersey*, the Finance and Economics Committee of the Island Parliament continued until this year to act as Regulator of the Island's finance industries with the support of public servants in the Financial Services Department. The Parliament decided last year, however, partly in response to the Bank Cantrade problems but also reflecting wider international trends, to set up a Financial Services Commission on similar lines to the Guernsey Commission and the new Financial Services Authority in the UK. The new Commission came into being on 1 July this year.

In *all the Islands*, the Parliaments approve appointments to the Boards of the independent regulatory authorities, on recommendations by the relevant Committee or Ministry. The Parliaments also retain the right to give written directions of a general nature (but not on specific cases) to the regulatory authorities, as well as passing the necessary financial, company and trust legislation. In the last resort, they could act to remove the

### Regulatory Boards.

In my opinion, the Island Parliaments have been right to set up independent regulatory authorities while retaining the powers mentioned in the previous paragraph. [The statutes should preferably specify the circumstances in which the Parliaments may remove Regulatory Boards or individual Board members.]

#### 6.3 *One or more regulatory bodies*

In *Jersey* and *Guernsey*, the Financial Services Commissions (FSCs) regulate the financial services institutions as a whole, including insurance and pensions business as well as banking, investment and securities business. In the *Isle of Man*, as noted above, a separate Insurance and Pensions Authority (IPA) regulates insurance and pensions business.

There are also some differences between the Islands in the extent to which the FSCs become involved in the registration and regulation of companies.

In my opinion, there is no absolute requirement to have one regulatory authority rather than two. The supervision of insurance business calls for a particular range of skills and experience.

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

to be more economical in terms of accommodation and overheads, including Board servicing;

- to facilitate flexibility and cross-fertilisation in the deployment of staff, and
- to help in the supervision of business common to different types of institution, notably investment business, and conglomerates.

#### *6.4 Board structures: political participation*

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

The Islands depart from standard international practice in the larger countries in their choice of Chairmen for the regulatory authority Boards. In Jersey and Guernsey, the



Chairman of the relevant Parliamentary Committee serves as Chairman of the FSC Board. In the Isle of Man, similarly, one of the Members of Parliament who comprise the Island's Treasury team serves as Chairman of the FSC and another as Chairman of the IPA.

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

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

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

centre's reputation.

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

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

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

Ministries or political committees.

For all the reasons discussed, and well though the present arrangements seem to have worked in practice, the Islands would in my opinion be well-advised to consider moving to independent professional regulatory Boards without political participation.

*6. 5 Board structures: balance of members*

The other main issue on the structure of regulator Boards is the balance of membership between professionals and consumer representatives and between people from inside and outside. The present Island Board members vary in numbers and backgrounds between the Islands.

Such Boards should preferably include people with relevant professional backgrounds who can contribute substantively to the Board's business. They should also include people familiar with and sensitive to the interests of customers, not least non-resident customers. In a different perspective, there is a strong case in small jurisdictions for having on the regulatory Boards one or two experienced people from outside the jurisdiction as well as people sensitive to the public interests of the jurisdiction itself. In practice, many Board members will fall into two or more of these categories. Also relevant to decisions on the balance between people from inside and outside the

jurisdiction will be the international experience of those from inside the jurisdiction and the proportion of professional staff from outside.

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

#### 6.6 Non-executive Boards

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

All Boards see themselves as responsible for setting policy and for approving the administration and budgeting decisions of the Director General (who is in all cases a Board member). Licensing and licence withdrawal decisions, too, mostly require approval by the Boards themselves.

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

In my opinion this balance is about right. Regulator Boards should wherever possible avoid becoming involved in decisions on individual cases. They should also as far as

possible leave the professional staff to make individual licensing decisions within agreed guidelines. The more the Boards themselves are involved in decisions on individual cases, the less possible it becomes to find well-qualified people without conflicts of interest to serve on them.

#### *6.7 Professional structures*

The Guernsey FSC is organised by type of business supervised, with a Director General's Division and three further divisions looking after banking, investment and securities and insurance respectively. The Jersey FSC will initially be organised along similar lines. But consultants have been commissioned to advise on the future organisation.

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

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

The most notable difference is on enforcement. In the Isle of Man, a separate and proactive enforcement division with [three] professional staff, including a former police officer, undertakes the enforcement tasks, including a prosecution role and responsibility for [money laundering enquiries], investigations and searches, responses to requests for assistance from regulatory authorities in other jurisdictions, and identification of unlicensed business operations. This seems to me to work extremely well.

A single staff member in the Director General's division in Guernsey undertakes some of the same responsibilities. In both cases legal and other specialist help is bought in from outside when required.

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

First, I believe that the IOM's FSC should consider the case for having four professional supervisors at Director level, all of whom would take part alongside the policy and enforcement Directors in the Director General's senior management committee, rather than one as at present. There would be a Banking Director, an Investment Director, an Insurance Director (if the two regulatory authorities are

merged) and a Companies, Trusts and Service Providers Director (to implement the proposed extension of the regulatory boundary to the service provider areas). The other FSCs, too, are likely to need an extra person or persons at this level to deal with the licensing and regulation of fiduciaries and service providers.

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

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

- Second, enforcement and the collection of evidence are specialist tasks which require specialist skills, training and practice.
- Third, such tasks tend to arise at short notice and can be highly disruptive to well-planned inspection programmes, both on and off site. They can also arise in relation to non-regulated institutions.

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

### *6.8 Resources*

The ratios of regulatory staff to levels of business and numbers of institutions monitored vary to some extent between the islands. Jersey FSC has 35 staff including 10 with professional qualifications. The corresponding figures for Guernsey are [36 and 121; and for the Isle of Man, (31 and 11), spread between the FSC and the [PA.

The studies made by the specialist regulators as part of this project confirmed the view of the regulator bodies themselves that there are rather too few qualified staff to discharge the present tasks of regulation, especially in the areas of on-site inspections and .... There seems to be a requirement for about .... extra staff

The Island authorities also accept that significant numbers of extra staff will be required to sustain the extension of the regulatory boundary (see Chapter ...below) to include investment business, corporate services business and trust business. Suitably qualified staff for these new areas of regulation will not be easily found. The Jersey



authorities foresee the need for [?5] extra professional staff for this purpose

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

Consistently with this, I believe it will be important to abolish the arbitrary “head-count” limitation which still exists in one of the Islands on the number of regulatory staff that may be employed.

The Islands also vary in the extent to which they have brought in professional staff from the UK and other jurisdictions. Guernsey have .... such staff, including the Director General and the Directors. The Isle of Man, too, employs professional staff brought in from outside, including the present and past FSC Director Generals. Jersey has relied more heavily on home-grown talent.

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

of experience they can bring.

### *6.9 Terms of reference*

The terms of reference of the regulatory bodies in the Islands mainly reflect the objectives set out in the first section of this Chapter. In [all] the Islands they include, rightly, in my opinion, an obligation to advise the Treasury or the relevant Parliamentary Committee on the development of regulatory policy and legislation.

The main difference in the terms of reference, compared with those of (say) the PSA in London, is that they include objectives to further the economic interests of the Islands [IOM not?] and, in the case of Jersey [CHECK], to promote the Island's finance industries.

In my opinion, it is reasonable to look to the regulatory authorities to have regard to the economic interests of the Island, especially when the Islands are as dependent as they are on their finance centres and have in practice to ration the number of people who establish businesses on the Island [through control of borrowing orders and housing or residence licenses better in Ch 2]

Promotion of the Islands' finance industries, on the other hand, does not seem to me a proper task for regulator bodies. The same person cannot readily "promote" the

Island's facilities to potential customers or newcomers one day and then appear again in the role of licensor or regulator on the following day. Dual roles of that kind may injure a finance centre's reputation.

In my opinion the industry promotion function is much better left to the Parliamentary Committee or Ministry which oversees the finance industry, and its supporting officials, in co-operation with the industry itself. The Regulators can and should be prepared to contribute to promotion material. They should not, however, be responsible for it.

#### *6.10 Coverage of regulation*

In all three Islands, the regulator bodies cover the supervision of banking, investment and securities and insurance business. They are also responsible for ensuring that institutions throughout the financial sector have good systems and practices for countering money laundering.

For company registrations business, the Islands' arrangements vary. In Jersey, the FSC is responsible for this. In Guernsey, the FSC supports the Law Officers in the registration of companies. In the Isle of Man, a separate Companies Registry is responsible for the Island's large company registrations business.

In my opinion, the nature of the companies sector in the Islands, and in particular its heavy concentration on investment and financial vehicles, is such that it makes good sense for the FSCs to be responsible for company registration. If the registration process is kept formally separate, close co-ordination is needed.

All three Islands have plans to extend the regulatory boundary to include investment business generally (in addition to collective investment schemes), corporate services (including company formations and provision of Director and management services) and trust companies (or trust service providers). When this has been achieved, regulation will extend to all categories of financial services for international customers.

For reasons discussed in later Chapters, I believe that the Islands are right to have policies to extend the regulatory boundary in this way, despite the considerable resource implications.

### *6.11 Customer protection against business failures*

Customer protection schemes, designed to give some protection to depositors, investors and policyholders if the banking, investment or insurance company

concerned should collapse, are another element in the coverage of regulatory authorities in many of the larger countries. Such schemes are mostly funded by the industry itself on a “pay as you go” basis.

The Isle of Man is the only one of the Islands that presently has such schemes in place. Jersey and Guernsey have both considered introducing them but have so far decided against.

Customers of institutions located in the Islands are not eligible for protection under UK schemes either, even if the parent bodies are UK institutions.

The Isle of Man introduced schemes on these lines in order to restore confidence after the Savings and Investment Bank collapse in 1982. The depositor protection scheme was activated after the BCCI collapse. The Island’s schemes are similar to those in the UK, where the maximum individual payouts are presently as follows:

- Bank and building society depositors: £18,000 (90% of the first £20,000 of loss)
- Qualifying investment schemes: £48,000 (100% of the first £30,000 plus 90% of the next £20,000)

- Insurance claims: no maximum limit but payment is mostly limited to 90%, with 100% payments reserved for specified compulsory insurance policies.

The FSA in the UK has published proposals to rationalise the present schemes and to gear them towards customers least able to sustain losses, notably individuals and smaller firms. The aim is to do this without removing the incentive to customers to choose carefully the institutions with which they do business.

EU Directives will shortly oblige member states to introduce protection schemes with upper limits of at least 20,000 ecu for investors as well as depositors. The EU does not at present have similar requirements on insurance.

For any financial centre committed to protecting consumers of financial services, the question whether to have such schemes is one that needs to be considered. Gibraltar is in the process of introducing depositor and investor protection schemes, in conformity with the EU Directives. In the Caribbean, such schemes exist but the benefits are usually confined to local people who belong to the islands and make use of local banks and insurance companies.

The arguments in favour of having such schemes, for international as well as domestic

customers, are that they significantly enhance customer protection, especially for small customers, and have now become a standard feature of the European onshore scene. Once established, they are not, of course, expensive for financial services authorities to administer unless and until an institution does collapse. If that does happen, the existence of the..schemes is likely to be a great benefit.

The justification usually advanced for doing without such schemes is that many of the customers of offshore centres are wealthy people and businesses for whom the maximum payment limits in such schemes would be drops in the ocean. There will, however, be many other, less wealthy, customers where this is not so.

A further consideration is that the scheme needs to be able to cover a major collapse within a reasonable time-frame. The contingent liabilities for Island institutions may therefore be considerable.

The conclusion I would draw is that, for any finance centre, such schemes are good practice. They may not yet be quite essential. But their adoption throughout the EU countries strengthens the case for having them in the Islands.

### *6.12 Customer disputes procedures*

The problems which customers of finance centres may have are not limited to cases where the institution or firm concerned has collapsed. The problems are at least as likely, and indeed more likely, to arise in relation to institutions or firms which remain in business. In such cases, customer protection and compensation schemes along the lines described in the previous section are not, of course, relevant.

The FSCs in all the Islands have procedures for handling customer complaints. In all cases, they refer the complaint to the firm or institution concerned. Sometimes there is discussion as well. But the FSCs' standard practice is not to intervene between institutions and their customers. Their principal concern is to consider any wider implications for the systems and practices of the institution or firm concerned.

The Islands, like other offshore centres, do not at present have any "Ombudsman" systems for considering customer complaints and resolving disputes. [Prevalent though among European onshore jurisdictions?]

Several customers of the Islands, both resident and non-resident, wrote to me about disputes they were having or had had with Island institutions and firms. I have no reason to suppose that such disputes are either more or less common in the Islands than in other finance centres. If I had invited the customers of other centres to write to me, I would probably have received similar



responses.

As discussed in an earlier Chapter, I have not sought to judge the rights and wrongs of individual cases. But I was struck by the amount of unhappiness generated. Many of the aggrieved parties argued that they had no effective means of redress. The local Financial Services Commissions were seen as being unwilling to help. The legal processes were seen as too long and too expensive, the likely outcomes as too uncertain. [Is legal aid available, to residents or non-residents, in the Islands?] Some of my correspondents seemed to have devoted large parts of their lives to correspondence with the institutions and firms concerned, with legal advisers, with the local Financial Services Commissions and with the relevant Parliamentary Committee or Government Department. In some instances, they had also made great efforts to generate publicity for their cases.

In my opinion, the Islands would be well advised to consider establishing an independent Financial Services Ombudsman to help resolve such disputes, even though other offshore centres do not as yet have anything comparable.

Potentially at least, there would be advantages for complaining customers, institutions complained against and regulators alike:

Aggrieved customers would be likely to welcome the opportunity to ask a visibly impartial tribunal to examine their cases, and to make or recommend awards, without incurring massive legal fees. Early resolution, even if the complaint is not sustained, may save years of misery.

For the institutions concerned, a framework for speedy resolution of disputes by an impartial tribunal should likewise be attractive.

For the Financial Services Commissions, too, there must be attractions in being able to advise complainants to take their complaints to the Ombudsman rather than simply declining to intervene. The appearance of unwillingness to help is an embarrassment for any organisation with responsibilities for customer protection.

A further advantage that Ombudsmen have is that they can take a broader view of what is reasonable, less constrained by the letter of the law, than the Courts are able to do.

The Guernsey FSC showed me some interesting proposals they have worked up for a Financial Services Ombudsman. Under these, the Ombudsman would Chair a panel of 12 people (many of them probably retired). For individual cases, the Ombudsman

or his alternate would sit with two people of appropriate experience drawn from the panel. Professional help would be commissioned from the FSC or private sector experts as appropriate.

The authorities estimated that costs might be around £10,000 in the first year but less thereafter. [Any proposals in the other Islands?]

This approach seems to me to have considerable merit. There are a number of other critical issues which would need to be considered in relation to the establishment of an Ombudsman. The recent consultative paper by the UK's Financial Services Authority, *Consumer Complaints*, discusses these.

For the Island finance centres, I would see a number of presumptions, as follows:

The Ombudsman scheme should apply to *all* financial institutions and service providers and should be industry-wide, not voluntary.

Customers eligible to complain to the Ombudsmen should be private individuals, unincorporated bodies, partnerships and small companies, resident or non-resident, who are or have been customers of the firm or institution complained against.

There should preferably be no inflexible published limit on the maximum amounts involved in cases which the Ombudsmen may consider.

Customer complaints should be made direct to the Ombudsmen. The Ombudsmen themselves, not the FSCs, should filter out cases which should not have been referred to them. They should have powers to exclude complex cases requiring judicial processes and frivolous or vexatious cases.

- For cases not sifted out, the Ombudsmen's first stage should be conciliation. In the UK, around 80 per cent of cases are resolved at this stage. The next stage should be an informal or recommended award. In the UK, 15 per cent of cases are resolved at this stage.

For cases not so resolved, there is an issue whether the Ombudsmen themselves should then make binding awards (and enforce them as required) or whether it should be for the Courts at that stage to determine whether the recommended awards are fair and reasonable, and to enforce them if so.

The Ombudsmen should be accountable to the Island Parliaments, and should submit published annual reports to them.

The Ombudsmen should be obliged to consult the Financial Services Commissions about standards of business behaviour to be expected in regulated bodies and to feed back case-information to the Regulators so that the Regulators may draw any necessary conclusions for regulatory systems generally.

#### BOX 6.1

#### FINANCIAL REGULATION AND COMPANY REGISTRATION [N THE ISLANDS

<i>Man</i>	<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of</i>
<i>Regulatory Staff August 1998</i>			
<i>(full-time equivalents)</i>			
Director General*			
Banking	6	4	3.5
Investment business:			
(a) CIFs	11	8.5	2.5
(b) Other	14	3	2

Insurance	3/4	?7	4
Trust and Company service providers	.	.	.
Company registration & supervision**	?8	9	9
Enforcement		1	3
Central policy & operations	?	3	8.5
Support staff**	7	7	8
TOTAL	42	31.5	32.5

*Licence and registration fee  
income, 1997, £ million*

*Expenditure, 1997, £ million  
Fee income as % of expenditure*

## NOTES

\* The Director of the IoM's IPA is scored in the Insurance row.

\*\* I suggest we enter here company registries staff as well as staff in the FSCs who work on companies.

\*\*\* I suggest we include under support staff (and exclude elsewhere in the table) staff responsible for accounts, technical services, secretaries, clerical & reception

staff. We should then show in all the individual sector tables, on banking, investment business and insurance, staff numbers *excluding* support staff.

The main obstacle, perhaps, to establishment of an Ombudsman system is cost. But the cost is likely to be small in relation to the benefits. Costs might be reduced, moreover, if the three Islands, or Jersey and Guernsey at least, were to establish a *joint* Ombudsman.

### *6.13 Finance centre staff training*

[Mention Guernsey scheme. Do J & IoM have similar schemes?]

## **CHAPTER 7: REGULATION OF BANKS**

## **CHAPTER 8: REGULATION OF INVESTMENT AND SECURITIES Business**

## **CHAPTER 9: REGULATION OF INSURANCE**

## 7

**BANKS***7.1 Introduction*

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

*7.2 Scale of business*

Jersey and Guernsey are international banking centres first and foremost. At the [end of 1997], their banks had total deposits of £96.5 billion and £53.5 billion, respectively. The Isle of Man has bank deposits of £19.3 million and a more even distribution between banking, investment and insurance business.

As indicated in the Box 7.1 table, all three Islands have between 60 and 70 licensed banks. But the average size of business, as measured by total assets or liabilities, varies. Jersey's pursuit of larger-scale business is reflected in average liabilities of £1.2 billion per bank. Guernsey banks have an average of £700 million and Isle of Man banks £280 million.



Jersey banks employ 4,700 staff (?about half of total finance centre staff). Guernsey banks employ some 3,100 staff (rather over half of total finance centre staff). The Isle of Man banks employ 1,800 staff (?about one-third of finance centre staff).

4

With limited exceptions, the banks in the Islands are locally registered companies subject to the normal 20 per cent rate of tax on corporate incomes.

### 7.3 *Type of business*

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

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

Parent banks in the UK and elsewhere introduce much of this business. Some banks undertake substantial company business as well.

In Jersey and (to a lesser extent) the Isle of Man, some of the banks have banking subsidiaries outside the Island. The Guernsey banks have no such subsidiaries.

#### 7.4 *Distribution of business*

As the Box 7. 1 table indicates, the Islands' banking businesses are no longer predominantly with the UK. In Jersey, Guernsey and the Isle of Man, UK residents account for some [17], 15 and 25 percent of deposits, respectively.

The proportions of funds invested in or through the UK are significantly greater, at 41 and 53 per cent respectively. There is consequently a substantial net inflow of funds through the Islands into the UK.

In Jersey and Guernsey, bank deposits are predominantly in foreign currencies. Sterling deposits are 41 and 34 per cent, respectively, of the whole. The Isle of Man remains more sterling-centred, with 70 per cent of total deposits in sterling.

#### 7.5 *Regulatory policy and legislation*

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

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

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

#### 7.6 *Licensing*

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

Taking the Islands in turn,

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

Guernsey authorities pursue a similar policy of rigorous vetting, with rather less emphasis on size.

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

#### 7.7 *"Host supervision"*

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

Once again, the position varies somewhat between the Islands:

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

- The Guernsey authorities have not allowed this. Their supervisory duties are therefore strictly limited to “host” country duties.

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

#### 7.8 *Other points on licensing*

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

- *Economic benefit criterion.* The Jersey and Guernsey legislation obliges the authorities to consider the economic benefit to Jersey and Guernsey. This seems to me acceptable provided that the regulator always puts prudential requirements first whenever there is any conflict. The legislation ought preferably to make this priority explicit. The Isle of Man legislation, like the UK legislation, has the merit of not including an economic benefit criterion.
- *Minimum criteria’ for licensing.* The laws in Jersey do not set out any minimum registration criteria. Some criteria could usefully be included when the legislation is next updated. In practical terms, however, the omission is not important.

*“Managed” banks.* In all the Islands the authorities are willing to license “managed” banks. Such banks have no separate physical presence on the Islands but are managed by Island banks. This enables the bank concerned to benefit from some of the advantages of a presence in the Islands and to gauge whether a full presence would be useful. In such cases the authorities impose two additional licensing requirements: approval of the local manager and the management agreement. Confirmation as to local books and records are also required from the bank’s auditors. Otherwise, supervision is the same as for other banks. For subsidiaries, the authorities insist on meeting the responsible Director from the parent bank once a year. [Is this correct for G & IoM?]

*Licence conditions and categories.* The authorities in all the Islands have discretion to attach conditions to the issue of licences. The authorities in Jersey and the Isle of Man use these conditions (and, in the Isle of Man, different licence categories) publicly to restrict the scope of individual banks’ businesses. The Guernsey authorities follow UK practice in treating such restrictions as a private prudential matter. The Isle of Man has a wider definition of banks.

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

#### 7.9 On-going supervision policy

The Island authorities have followed the *traditional UK approach* to on-going supervision, based on off-site analysis of monthly and quarterly prudential and statistical returns (now beginning to be electronically reported in Jersey and Guernsey) and prudential meetings, mostly annual, with the banks' senior managements.

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

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

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

### 7.10 *Particular issues on supervision*

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

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

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



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

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

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

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

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

The Guernsey authorities apply standard guidelines and limits, including a maximum 20 per cent guideline for the cumulative negative mismatch to one month before allowing for marketable assets. The Jersey and Isle of Man authorities are less prescriptive. Mr Sutherland has suggested that they would do well to adopt a more proactive approach.

### *7.11 Lessons from recent cases*

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

#### *(a) Bank Cantrade in Jersey*

Chapter 15 of the Jersey Chapter describes the recent case involving Bank Cantrade, a UBS subsidiary, a foreign currency trader and his accountant.

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

(b) *Barings and O'Sullivan in Guernsey*

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

to continue in business.

Mr Sutherland and Mr Sears have suggested that the Guernsey authorities should consider introducing some form of rescue, moratorium or administration procedures, as in the UK, to help in dealing with such situations. The Jersey and Isle of Man authorities appear to have a similar need.

In the *O'Sullivan* case, also referred to in the Island Chapter, the Guernsey authorities prosecuted the managing director of a local institution who fraudulently induced investors to invest monies on deposit by dishonestly concealing the withdrawal of his institution's licence to take deposits. The person concerned was convicted and received a one-year suspended prison sentence and a £28,000 fine. Many depositors, however, lost all or most of their money.

In my opinion, this case underlines the importance of having pro-active and well resourced enforcement units, with effective powers of investigation, in all the Islands' FSCs. As discussed in Chapter 6, only the Isle of Man has such a unit at present. Units on these lines are needed both to police the "perimeter" of unlicensed business (before customers suffer) and also to use civil procedures to take the profits out of crime. Chapter 14 picks up this theme.

(c) *BCCI in the Isle of Man*

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

The BCCI saga clearly underlines the importance of initial vetting for licences. In common with the regulatory authorities in many other countries, the Isle of Man's FSC clearly failed to identify the risks in licensing BCCI.

The trader solicited funds from investors for foreign currency trading, initially in 1988; placed them with Bank Cantrade in Jersey; made foreign currency transactions from which both he and the bank earned significant commissions; and lost about \$11 million; but misled investors by falsifying the accounts to indicate profits of some \$15 million.

A. partner from Touche Ross in England certified the false accounts. A representative of the bank, too, made false statements as to the trading performance.

The Jersey Finance and Economics Committee received a customer complaint in 1993. The Jersey police investigated the complaint. The Committee decided not to make its own investigation but commissioned a report from Coopers and Lybrand, the bank's auditors. The Jersey authorities brought prosecutions in 1995 against the bank, two bank staff; the dealer and the accountant.

At the trial in 1998,

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

charges against the two individual bank staff were dropped

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

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

With regard to regulatory aspects of the case (Chapter 1 5 discusses the criminal aspects), the case seems to me to confirm how right the Jersey authorities have been to develop their regulatory structures, policies and practices in the way they have in the past year or two. Three key developments in this connection are:

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

*In vestment business Law.* With implementation of the new Investment Business Law, the trader's activities and the foreign currency investment fund would now be subject to regulation. It is, indeed, most unlikely that the trader concerned (? or a fund which offered investors the assurance of high returns on a manifestly speculative investment) would have been licensed in the first place. As it was,

such activities and such a fund were at no time subject to regulation. It is surprising, even so, that they slipped through the net. For the Jersey authorities have made a point of rigorous vetting of new financial businesses through powers available under the Control of Borrowing Order and the housing permits legislation.

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

Some further reflections prompted by this case are:

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



- *Island Rules of Business Conduct.* There is a case for developing Island Rules of Business Conduct for bankers and those involved in investment and insurance business.

In the Cantrade case, it appears that the financial arrangements between the trader and the bank were such as to give both parties an incentive to multiply or “churn” transactions, without regard to the interests of investors. Regulatory authorities, not just in the Islands, have traditionally seen such “conduct of business” issues as being not for them but for bankers and other professional associations to develop for themselves through voluntary Codes of Conduct. They have traditionally limited themselves to “prudential” supervision, designed to ensure that risks are well managed at an aggregate level and the dangers of insolvency are consequently minimised.

In the UK, there are conduct of business regulations which (among other things) prohibit “churning” The Jersey and Guernsey authorities will do well, in my opinion, to develop similar Rules or enforceable Codes, drawing on UK and Isle of Man models, supplemented as necessary by voluntary Codes. [The authorities in both Islands have this in hand]. They might also consider developing such Rules jointly.

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

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

(d) *Conduct of business cases*

Aggrieved customers wrote to me about other cases involving banks and *I* or investment funds in the Islands. In all cases, the customers were dismayed that the Islands' FSCs, while becoming involved, had declined to intervene. As discussed in Chapter 6, I believe that a Financial Services Ombudsman might well have been able to promote solutions in many of these cases.

7.12 *Resources*

As discussed earlier in the Chapter, the FSCs in all the Islands seem somewhat

understaffed for the tasks of banking supervision. The introduction of on-site inspections, as called for in the Basle Committee's core principles, will reinforce the case for extra resources.

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

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

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

## **8 Investment and Securities Business**

### *8.1 Introduction*

This Chapter draws heavily on a review of the regulation of investment and securities business in the Islands commissioned by the Home Office at my request

from Mr Guy Sears. I am most grateful to Mr Sears.

## 8.2 *Types of business*

In all the Islands, the investment business consists mainly of the management, administration and custody of collective investment schemes. These schemes include:

- *“recognised” open-ended investment schemes*, including unit trusts, which the Island industries are permitted because of their “designated territory” status to market to the general public in the UK and in practice in certain other countries as well;

*“non-recognised” open-ended investment schemes*, designed for institutions and professional investors but not permitted to be marketed to the general public; and

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

The Treasury in London has granted “*designated territory*” status to all three Islands. This

enables the Islands' industries to market their "recognised" open-ended investment schemes to the general public in the UK. Before granting this status, the Treasury has to satisfy itself that the jurisdiction in question has a standard of regulation for the schemes concerned equivalent to that of the UK.

The grant of designated territory status has helped the Islands' industries to market their schemes more widely as well. The Jersey industry, for example, can market Jersey schemes to the general public in Japan, Ireland, Hong Kong, Australia, the Netherlands and Switzerland.

The Jersey authorities, in turn, have allowed fund managers from the UK, the US, Germany, France, Switzerland, Sweden, Australia and other countries to launch Jersey-based funds.

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

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

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

*investment advisers;* and  
stockbrokers

### 8.3 Scale and Distribution of business

The accompanying Box 8. 1 gives some indication of the scale of these businesses. The figures are collected on different bases in each Island and should therefore be interpreted with caution.

For collective investment schemes, the Jersey authorities estimate that the total amounts invested may be around £35 billion in around 1100 schemes (an average scheme size of £32 million). The Guernsey authorities estimate total amounts invested of around one-half of the Jersey figure and the Isle of Man around [one-third].

To judge by the Guernsey figures, “non-recognised” open-ended schemes have been the main growth area. Such schemes now account for about half the total for all schemes. “Recognised” open-ended schemes account for only 20 per cent. Closed-ended schemes account for the remaining 30 per cent.

The Guernsey authorities estimate that only around 11 per cent of the funds invested come from the UK.

#### 8.4 *Tax status*

[For the most part, collective investment schemes are constituted in the Islands as tax exempt companies (see Chapter 10).] [Is there a separate point about no tax being payable where the income is distributed to non-residents?]

#### 8.5 *Licensing and Regulatory policy*

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

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

The authorities also continue to use their powers under long-established Control of Borrowing Orders to control what investment businesses may be established on the Islands. Significant numbers of applications are refused.

#### 8.6 *Legislation and Codes of Conduct*

All the Islands now have legislation and supporting Codes in place to license and regulate investment business along broadly UK lines. Some differences from UK legislation and systems are discussed below

The Jersey and Guernsey authorities initially licensed and regulated only collective investment schemes. Licensing and regulation of these schemes on UK lines were needed to give the Island industries access to the UK market as explained above. Guernsey introduced a Protection of Investors Law in 1987 Jersey followed in 1988 with a Collective Investment Funds Law.

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

The Isle of Man introduced a comprehensive Investment Business Act in 1991, based on the *UK's* Financial Services Act 1986, for the licensing and regulation of all investment business.

In Guernsey and the Isle of Man, the Codes have the status of rules and the FSCs have power to enforce them. In Jersey, the Codes will not be similarly enforceable but



will be usable in Court as evidence of best practice.

In the opinion of Mr Sears and myself, the Guernsey and Isle of Man approach in this respect is preferable. We hope, therefore, that the Jersey authorities will adopt a similar approach. This could be achieved by giving their Codes the status of Rules as well as making use as necessary of licence conditions.

#### 8.7 *Licensing of schemes and scheme providers*

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

The Island authorities also issue permits for *individual schemes*:

For “*recognised*” schemes, the requirement is universal. These schemes have to meet UK-style requirements in terms of marketing, management and permitted investments.

For *other schemes*, the licensing and regulatory details vary between the

Islands. In all cases, however, the requirements are less prescriptive and lighter for “non-recognised” schemes, closed-ended schemes and debt issues than for “recognised” schemes.

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

The Jersey law departs from practice in the UK and the other Islands in explicitly not applying at all to investment products (which would otherwise be schemes) offered to an identifiable class of informed persons not exceeding 50 in number over the full life of the scheme. In my opinion, this goes too far. [Is this total exemption really appropriate? Might it not mean that the foreign exchange fund in the Cantrade case would not have been subject to a permit<sup>9</sup>].

#### 8.8 *Licensing of other activities and providers*

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

dealing,

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

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

The main exceptions are:

- In Jersey, the licensing and regulation requirements do not extend to *arranging deals*. Various categories of intermediary are consequently excluded. The argument has been that intermediaries off the Island are responsible for most arrangement of deals. But it would seem better not to assume that this will always be so.

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

- In the Isle of Man, similarly, *long-term insurance products* are not subject to conduct of investment business regulation if sold by the insurance

company's own staff. The same products *are*, however, subject to this regulation if sold by independent financial advisers. It seems clear that such products should be subject to conduct of business regulation regardless of who sells them.

The authorities in each of the Islands would preferably in my opinion take a convenient opportunity to make good these lacunas.

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

#### 8.9 *Client accounts and custodial services*

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

- In Guernsey, the law does not explicitly declare that client account assets held by a firm in the name of a client are held in Trust and cannot therefore

be treated as available assets in the event of the firm's insolvency. This omission would preferably be rectified as soon as practicable.

- In Jersey, the Investment Business Law does not list custody as a regulated activity. The authorities intend, however, to cover this point in the forthcoming Fiduciary and Administration Business Law.

#### *8.10 On-going supervision*

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

##### *(a) On-site visits*

In all the Islands, Mr Sears found good programmes for regular on-site inspections of collective investment schemes.

Effective supervision of investment business areas other than the schemes will require

relatively frequent on-site inspections, especially in the early years. The Jersey and Guernsey authorities' in particular, need to have this in mind as they implement this extension of the regulatory boundary.

With regard to existing programmes some points which arose were:

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

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

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

(b) *Whistle-blowing by auditors*

In [all] the Islands, the auditors are (or will be) required to “whistle-blow” to the FSCs and cannot be sued for breach of confidence.

*(c) Powers to investigate*

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

- In the Isle of Man these powers are very similar to those in the UK

In Jersey normal inspection powers can only be exercised after notice and there are no right of entry powers. But where unauthorised business or misleading statements are suspected, the Bailiff may authorise a requirement for immediate compliance, including entry and search warrants.

In Guernsey, the powers are similar except that there is no power to search and seize and no offence of failing to answer. These points could be remedied when the law is amended to reflect the ECHR Saunders judgement on self-incrimination.

*(d) Powers to enforce*

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

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



wind up or bankrupt persons in the public interest

The Jersey authorities' powers, though similar, do not include powers to apply for restitution for investors who previously suffered loss, or seek injunctions and restitution for breach of regulatory codes.

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

- name and shame,  
seek injunctions against misleading statements, or
- ban individuals.

In my opinion the authorities in both Islands would be well-advised to take an early opportunity to add these powers to their otherwise highly effective arsenals.

(e) *Policing the perimeter*

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

The Jersey and Guernsey FSCs have not in the past focused on policing the perimeter in the same way. As discussed in Chapter 6, however, they would in my opinion be well-advised to make this part of their core function and to establish enforcement units accordingly.

8.11 *International co-operation*

Despite occasional misunderstandings, the Islands' FSCs generally have a good reputation for co-operating with regulatory authorities overseas.

The *Guernsey* regulators have made a special point of good co-operation and have least impediments in doing so. Although the Protection of Investors Law does not include mutual assistance provisions, FSC staff are able to share information in the pursuit of regulatory offences and breaches within a general requirement of

confidentiality of information from which individuals or bodies can be identified.  
Confidential information of this kind can be passed to any overseas regulator:

- in the public interest,  
in the interests of detection or prevention of crime, and  
in compliance with a direction by the Royal Court.

There is no specific requirement for approval before information can be passed nor any special protection for customers.

The *Isle of Man's* FSC, too, has made a special point of good co-operation, both proactive and reactive. The powers are similar to those in the UK. The Island's Banking and Protection of Investors Acts both empower FSC staff to share information provided that this is in the public interest and the information will be of value to the recipient.

The main difference, compared with the UK, is that the Chief Minister<sup>1</sup>'s approval is required for giving of information relating to the affairs of a customer. I am not aware that this requirement has caused problems in practice. But it seems unnecessary as well as a potential source of delay. In my opinion, therefore, it would better be dropped.

*The Jersey* authorities have adopted a cautious approach to international co-operation in the regulatory field as well as in criminal matters. The FSC will have mutual assistance powers under the new Investment Business Law to make inspections and investigations so as to assist overseas regulators. But the new provisions do not allow FSC staff to pass to overseas regulators information relating to the identity of customers or others who have done business with a registered person (even customers who are themselves regulated by an overseas authority). There is, moreover, no provision for overriding this prohibition. [Am I right in thinking that these powers, and the associated prohibition, relate not just to investment business but to all FSC information?]

I hope that the Jersey authorities will be willing to repeal this prohibition.

The legislation in all the Islands couples a general immunity for FSC staff with a provision borrowed from earlier UK legislation, now amended, making breach of the statutory confidentiality provisions a strict liability criminal offence. This seems excessive. It sends the wrong signal about international co-operation both to staff and to the rest of the world. It would better be amended, as in the UK, to provide for a defence of due diligence.

Insider trading is an area where overseas regulators often need co-operation. Although the FSCs are not prosecuting authorities for insider dealing offences, they can appoint investigators or (in Guernsey) obtain disclosure Orders from HM Procureur.

The Jersey authorities are preparing a new Insider Dealing Law. A key requirement will be to draw the definition of securities violation and fraud as widely as possible so as to ensure that co-operation can be given. In both Jersey and Guernsey, offences under the Law should preferably include, as in the UK and the Isle of Man, creating false markets in securities

8.13

*Channel Island Stock Exchange*

**The Guernsey FSC has announced plans for the introduction later this year of a Channel Islands Stock Exchange (CISE) based in St Peter Port, Guernsey. The Cayman authorities introduced such an Exchange earlier this year. [Bermuda ?] The Dublin Special Trading Zone and Luxembourg likewise**

**have Exchanges This will, however, be the first Exchange in the Crown Dependencies.**

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

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

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

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

- For collective investment funds, a Stock Exchange listing is a powerful marketing tool. Fiduciary investors, for example, are commonly limited to quoted shares. Many of the Islands' existing funds are listed accordingly on the London Stock Exchange or other Exchanges.
- Both for collective investment funds and for other instruments, Stock Exchange listings offer the prospect of liquidity advantages and the reassurance of "best execution" prices.

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

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

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

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

#### *8.14 Resources*

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

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

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



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

BOX 8.1

INVESTMENT BUSINESS AND SUPERVISION

	<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of Man</i>
<i>Numbers of Funds Providers</i>			
Investment fund managers	25	?	23
Funds	335	196	7101
Separate investment pools / schemes	1100	711	9
Investment advisory businesses	50	9	59
Stockbroker businesses	12	9	9
<i>Scale of funds business</i>			
Amounts invested, £ bn	35	16.7	?
Of which			
Open-ended 'recognised' schemes	7	3.3	)
Open-ended other schemes	7	8.3	) 7.5
Closed ended schemes	7	5.1	
Proportion of investments from UK	9	11 %	
<i>Staff in the industry</i>			
Total	72,900	1,921	71,229
Of which.			
Investment	7	44.1	7
Trust & other fiduciaries		724	
Accountants	9	750	7
Other	7	66	
<i>Investment Staff in the FSCs</i>			
Total	15	11	35
Of which			
Schemes	11	5	2
Other	4	1	15
<i>Supervision ratios</i> (per scheme regulator staff member)			
Value of schemes, £bn	2.3	2.1	25.5
Number of Schemes	100	90	21,751
Investment staff in the industry	?	40	?

## 9 INSURANCE AND PENSIONS BUSINESS

### 9.1 Introduction

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

### 9.2 Scale, type and distribution of business

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

On captive and commercial insurance, Guernsey leads with some [350] companies and gross annual premium income of some [£1.5 billion]. The Isle of Man has [164] companies and gross premium income of £0.9 billion.

The principal owners of captives are large companies, mostly UK companies or multinationals, wishing to undertake some of their own insurance risk as a cost-effective means of handling their total risks. Some captives, however, have developed substantial third-party business including re-insurance [possible to quantify?].

On life insurance, the Isle of Man leads with some 15 funds, gross annual premium income of £1.5 billion and assets of [7] billion. Guernsey has 6 life funds, gross annual premium income of [~ billion] and assets of £[6.5] billion.

The parent companies for life insurance business are [? mostly based in the UK or other European centres. The companies serve mainly UK and other expatriate customers?]

The Isle of Man and Guernsey [?also host some offshore pension funds [quantifiable?]. These are [? mainly established by multinational companies for internationally mobile staff].

Jersey has only recently begun to compete for insurance and pensions business and has only a small sector, comprising 9 captives and commercial companies and 4 life funds.

All three Islands have designated territory status under section 130 of the UK's Financial Services Act, 1986. This enables their life insurance companies to market their products to UK residents.

As implied above, and in contrast with the banking and investment sectors, the Islands' insurance [and pensions] business is still heavily oriented towards UK companies and clients. In Guernsey, for example, about three-quarters of the companies have UK parents and UK residents account for about three-quarters of the premium income. The UK share is, however, declining as increasing numbers of customers are attracted from elsewhere.

### 9.3 Management companies

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

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

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developed new forms of related vehicles for financial guarantee business and protected cell companies (see below).

#### 9.4 *Tax status*

The Islands' locally registered insurance companies mostly choose to be constituted as tax exempt companies (see Chapter 10) but include some international business companies as well. The choice depends on the nationality and tax circumstances of the parent group. For the most part, however, locally established insurance companies can obtain favourable tax regimes relative to onshore companies conducting similar business.

#### 9.5 *Regulatory objectives*

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

to protect policyholders and investors through effective licensing and supervision designed to ensure solvency and good conduct of business;

to support the development of successful insurance sectors bringing economic benefits to the Islands;

to prevent and deter the use of insurance vehicles for money laundering and other forms of financial crime; and by all these means

- to protect and enhance the reputations of the Islands' international finance centres.

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

#### 9.6 *Modalities of regulation*

Especially in Guernsey, the authorities implement the regulatory regime mainly through the local insurance managers described above. All insurance companies and funds are required to identify a general representative, who is usually the same person as the Insurance manager. The regulators mainly exercise supervision through regular contact with these general representatives. The Isle of Man similarly [requires every insurer to have local management or to appoint a registered insurance manager.]

#### 9.7 *Policy issues*

There are four major issues which the Island authorities, like other offshore insurance authorities, have to address on a continuing basis.

##### (a) *Supervision versus economic development*

In the Islands as elsewhere, insurance regulators have tended to play a more critical part than banking or investment regulators in supporting the industry's progress and in the development of new products. The industry's competitive position, and in particular the development of new products,

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depend importantly on the regulatory framework. Hence the regulators themselves have tended to be active in development work alongside the exercise of prudential supervision.

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

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

In my opinion the solution lies in the observance by regulators of two key principles.

- First, they have an absolute duty not to sacrifice regulatory standards to commercial advantage. Their first responsibility must be to protect the interests of customers and the Islands' wider reputations.
- Second, they need to be, and be seen to be, impartial. This is entirely consistent with supporting the industry's progress, facilitating the development of new products and effectively publicising the regulatory regime. It is not consistent with "hard selling" or aggressive marketing.

(b) *Flexibility and differentiation*

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

The Island authorities have been fairly successful in tailoring regimes to legitimate customer requirements. As discussed below, however, the form of the legislation is not ideal

(c) Division of responsibilities between supervisors

The division of duties between insurance supervisors in the Islands and those in other jurisdictions is less well specified than in the banking sector.

As already discussed, many of the insurance companies operating in the Islands have parent companies which are subject to regulation in other, mostly onshore, jurisdictions. This is indeed a source of strength for the Islands' industries. The Island authorities sometimes insist on consolidated supervision by the parent company's supervisors as a condition for granting a licence. For the most part, however, the Island supervisors have to take responsibility for companies operating on the Islands.

In my opinion, clear allocations of responsibility are needed in this as in other areas of regulation. The International Association of Insurance Supervisors is discussing the matter but is not expected to reach an early resolution. In the meantime, I see a strong case for having explicit agreements with the supervisors of parent company jurisdictions.

(d) *Conduct of business*

As in the banking sector, insurance supervision has traditionally been concerned with prudential and solvency issues. Conduct of business supervision is only now beginning to be developed in the main onshore centres. I hope that the Island authorities will set ~ firm objective to follow best international practice in the development of such supervision.

9.8 *Legislation*

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

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

In all cases, the legislation covers both domestic insurance, for Island residents, and offshore insurance for non-residents. As discussed above, however, the requirements of the domestic and offshore sectors are very different, as are the requirements within the offshore sector itself. The authorities faced considerable problems, therefore, in seeking to cover such requirements in a single piece of legislation.

The authorities in Guernsey and the Isle of Man responded to these problems in somewhat different ways.

9.9 *Protected Cell Companies*

The Guernsey authorities introduced legislation in 1997 for Protected Cell Companies (PCCs). This is a new form of company vehicle designed to make the advantages of captive insurance available to smaller companies by reducing costs. Bermuda and the Cayman Islands have similar legislation in place. The Jersey and Isle of Man authorities have decided against introducing such legislation, for the time being at least.

The basic idea is that the insurance manager, instead of setting up separate captive company vehicles for the businesses of each insurer, sets up a single company vehicle and writes the various businesses into separate cells within the single vehicle. There is in principle, therefore, one set of legal expenses and one capital requirement, shared between the insurers taking part, instead of multiple legal expenses and capital requirements. The participating insurers rent space in a common, partitioned vehicle and thus avoid having to set up their own separate vehicles. But the assets of one cell are protected by law from the liabilities of another.

The protected cell structure can in principle offer similar economies for investment funds. Guernsey now has 9 Protected Cell Companies for insurance and 1 for investment funds.

A critical question, which has prompted considerable debate, is whether the protection of the cells would stand up in the event of legal challenge. If one of the cells became insolvent, and the PCC's common capital was insufficient to pay the debts, the liquidator or others would doubtless seek to realise assets from the other cells to pay the creditors. Depending on the scale of the debts, the other cells too could be put at risk.

In the view of the lawyers I have consulted, Courts in all the major jurisdictions would consider ineffective protected cell structures established by means of contracts within an ordinary company.

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Such contracts would be seen as an attempt to put shareholders above creditors. The other cells would be deemed liable, *pari passu*, if the company's capital was insufficient.

The question, therefore, is whether the Guernsey law would give the other cells protection where a contractual agreement would not.

If the case were heard in Guernsey and the assets were in Guernsey, the structure would doubtless be effective.

In other cases, however, as the Guernsey authorities themselves have been the first to acknowledge, there is no knowing whether Courts would accept the structure or set it aside. If, for example, the case came before an overseas Court, such a Court might well order that PCC assets in its jurisdiction be applied to meet PCC debts in its jurisdiction irrespective of the cell from which the debts (or the assets) came. If the case involved insolvency, moreover, the Court might well order recourse to assets in other jurisdictions as well.

The Guernsey legislation provides wide discretion for the FSC regulators, including substantial "waiver" powers, in key areas such as approved assets, paid-up capital and annual accounts. The solvency margin requirements, however, reflect UK and EU standards.

The Isle of Man legislation couples a similarly discretionary approach with setting of certain key requirements at the lowest level of need.

The discretionary nature of the legislation has not prevented the authorities in the two Islands from implementing effective regulatory systems over the past ten years. It has meant, however, that the regulatory regimes lack transparency. The legislation does not make clear what the regimes for individual sectors, in particular the life insurance sector, will be in practice.

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

separate laws for the domestic and offshore business, and

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

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

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

In the Isle of Man, the main such issues appear to be solvency margin requirements, which need to be reviewed against the latest UK and EU standards; prescribed valuation criteria for appointed and consulting actuaries, so as to ensure common reporting standards; and strengthened forms of actuarial certificate.

In Jersey, the main issues appear to be the definition of fit and proper (which needs to include competence), the extent of the discretion to grant licences, the requirement to explain rejection of licence applications, an obligation to notify key personnel changes, the obligations of appointed actuaries, a requirement for local representatives and records, strengthened enforcement and wind-up powers, removal of the limitations on powers to co-operate with overseas regulators, and repeal of

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the waiver and exemption powers. In addition, the Island's Finance and Economics Committee retains some powers that would normally rest with the regulator.

In the opinion of the experts I have consulted, the Jersey authorities need to move quickly to strengthen or (better) replace their legislation. In the meantime the authorities are co-operating closely with the UK authorities over supervision of the principal life insurance fund established on the Island.

This uncertainty is clearly a factor which any potential participant in a protected cell structure needs to weigh carefully. The Guernsey authorities have rightly, therefore, been scrupulous in making clear that the uncertainty exists. [They should] [They have also been at pains to] ensure that firms offering the facility are similarly scrupulous.

#### 9.10 Licensing

In insurance as in other areas, the Island authorities vet applications for licenses carefully with a view to admitting quality.

The Guernsey and Isle of Man authorities have well-established procedures. Applicants are subject to "fit and proper" assessments. They have to submit 5-year business plans and personal particular forms for every key member of the applicant organisation. The applications are vetted in accordance with the "four-eyes" principle by at least two senior staff members.

In Jersey the vetting procedures are understandably less well-developed. The main points for consideration are similar to those already mentioned in relation to the legislation.

#### 9.11 On-going supervision

In all the Islands on-going supervision depends importantly on scrutiny by the FSC regulators of annual returns, including audited annual accounts, reports by consulting actuaries and auditors, and business plans. [As in the UK,] on-site inspections are not well developed. The Island regulators employ consulting actuaries and accountants to help in these tasks.

Some elements of good practice identified by the experts I have consulted, including some already mentioned above in connection with the legislative frameworks, are:

- *Annual accounts.* As in Guernsey and the Isle of Man, insurers should be obliged to draw these up in accordance with an acceptable GAAP relevant to insurance operations. The Jersey authorities do not at present have such a provision. They should drop the provision they do have which allows them to waive the requirement for submission of accounts and auditor's reports.
- *Business plans.* As in Guernsey, annual submission of these alongside the accounts should preferably be a continuing requirement. The plans should preferably cover a 5-year period and should certainly be rolled forward each year.
  - *Solvency margins and actuarial criteria.* The Island authorities need to keep minimum solvency margins under constant review against the best offshore centres. There is a related need to develop standard criteria or valuation rules for consulting actuaries so as to ensure that reporting is to a common standard

*Actuarial certificates.* Appointed actuaries should be required in their annual certificates to endorse the valuation basis used, the adequacy of records and the matching of assets to liabilities in nature



and term.

*General Representatives.* The Guernsey requirement that registered insurers should appoint general representatives (usually the authorised insurance managers) to be the main on-going point of contact with the regulators seems to be a point of considerable strength, especially with regard to captive and commercial business.

*Whistle-blowing.* Obliging auditors, actuaries, managers and staff to whistle-blow to the authorities about breaches of regulatory procedures is a powerful device in ensuring compliance. The Islands' legislation could be strengthened in this area. The Jersey legislation already includes a valuable provision on these lines with regard to auditors, though it is not yet in operation.

*Money laundering systems.* Life and other long term insurance products, especially single-premium, large deposit and re-insurance products, are potentially attractive vehicles for money laundering. The Isle of Man authorities have instituted especially good systems for combating money laundering in the insurance area, including a requirement that the annual Directors' Certificate and Auditors' Report certify full and effective compliance with the Island's money laundering guidelines. The Guernsey authorities might like to consider adding a similar requirement to their otherwise well-designed systems. The Jersey authorities are less well advanced [but are fully committed to the early introduction of similar systems in insurance as well as other finance sectors].

*On-site inspections.* The Guernsey FSC staff are able to make on-site inspections in case of need. But such inspections have so far been ad hoc and infrequent. The Isle of Man and Jersey authorities do not at present make on-site inspections.

As noted above, the UK's regulatory regimes have likewise made limited use of on-site inspections, well-established though they are in some other jurisdictions. This doubtless reflects in part the focus on prudential rather than conduct of business supervision.

Especially if the UK authorities move towards more on-site inspections, hope that the Island authorities will do likewise. The authorities could usefully take powers to appoint reporting accountants, actuaries or other professionals as well as to make inspections themselves.

*Procedures and manuals.* In all the Islands, there are "four-eyes" procedures for signing off annual returns from the supervised population. Up to date procedures manuals for dealing with such returns are an invaluable tool, especially when staff change.

#### 9.12 Investigation and Enforcement

For the most part, the authorities' powers to investigate, intervene and petition for winding up of insurers appear satisfactory. In my opinion, however, the powers available to the Jersey authorities would not facilitate swift and timely responses to regulatory problems. There is no provision, either, for the regulators to petition the Court to wind up insurers.

#### 9.13 Co-operation with overseas authorities

The Guernsey and Isle of Man authorities have powers to co-operate with regulators overseas in the pursuit of regulatory crimes or breaches. They devote considerable resources to such co-operation. One of the overseas authorities to whom I spoke particularly commended their co-operation.

The Jersey powers to co-operate exclude, among other things, information relating to persons who have transacted business with a permit holder. This would appear, among other things, to prevent disclosures about the insurers using offshore reinsurers. The authorities may wish to remove these

limitations.

#### 9.14 *Protection of policyholders and Ombudsman*

The Isle of Man is alone among the Islands in having a policyholder protection scheme. Based on the Life Assurance (Compensation of Policyholders) Regulations, 1991, the scheme applies to life assurance companies. It offers protection for up to 90 per cent of the liabilities of any life company that becomes unable to meet its obligations. It has not yet been activated. Payments under the scheme would be financed by a once-only levy (not, as in the Depositors' Compensation scheme or the UK's schemes a levy subject to an annual limit) on the remaining life assurance companies, up to a maximum of 2 per cent of the actuarial liabilities. [What exactly does this mean? And what happens if this is not sufficient to finance the protection offered by the scheme? May need to note a problem here.]

The Jersey and Guernsey authorities have alternative trust arrangements which have been approved for the UK Financial Services Act 1986 Section 130 designated territory requirements. [Add a sentence on what these involve.]

As discussed in Chapter 6, the authorities in Guernsey and Jersey would in my opinion be well-advised to consider the introduction of Policyholder Protection schemes, with arrangements if necessary to supplement levy funding. [Possible reference to IoM funding.] Such schemes may not be popular with the providing institutions. They are, however, an element in good practice which has not impeded development of the Isle of Man's life insurance sector.

The insurance sector would also fall within the ambit of the Financial Services Ombudsman scheme mentioned in Chapter 6.

#### 9.15 *Pensions*

None of the Islands has special legislation in place for pension schemes or a developed regime for supervision of such schemes.

The Isle of Man is, however, considering the development of such a regime. The draft legislation which has been prepared is based in part, but only in part, on the UK's Pensions Act 1995.

Compared with the UK regime, the proposed Isle of Man regime would have stronger trusteeship provisions, including "fit and proper" testing. It would also extend "whistle-blowing" obligations beyond auditors and actuaries to trustees, investment managers and scheme administrators.

It would not, however, have the same minimum funding requirements as in the UK. There is also no proposal at present for compensation or ombudsman schemes.

Developing a supervisory regime will be a considerable task requiring considerable resources. Such a regime should preferably be tried and tested in the domestic market before being extended to the offshore market.

Insurers in Guernsey offering pension-style contracts are subject to regulation there under the insurance legislation. [Does this mean that only limited pension offerings are available in Guernsey? What about Jersey?]

#### 9.16 *Priorities*

In my assessment, the authorities in all the Islands should give priority at all times to ensuring that

the supervisory regimes for longer term products, especially life assurance, are well-judged, effective and up to date. Within the captives area, supervision of third-party business deserves a special priority.

As discussed above, the authorities in each of the Islands are reviewing their legislation with a view to strengthening their supervisory regimes. The need for this seems particularly urgent in Jersey.

### 9.17 Resources

In insurance as in other areas, the Islands’ regulatory authorities rely critically on one or two professional members of staff. Staff quality and experience are therefore all-important.

As to numbers, the Box 9.1 table indicates the present numbers of staff in post. The regulatory authorities in Guernsey and Isle of Man both propose, rightly in my opinion, to add [one] additional analyst (net) to their staff. With the possible exception of supervisory regimes for pensions, this should enable them to tackle the issues discussed in this Chapter. If the two regulatory authorities in the Isle of Man are merged, as discussed in Chapter 6, there could then be a compensating saving in support staff.

In Jersey, there is only one professional staff member dealing with insurance. The person concerned also devotes about one-quarter of his time to acting as finance director for the new FSC (potentially a considerable task during the FSC’s first year or two of operation). The insurance sector remains small. As discussed above, however, the agenda of legislation and supervision issues to be tackled is considerable.

In my opinion, the Jersey authorities need to recruit a further well-qualified staff member with experience of insurance supervision to work alongside the present member.

**Box 9.1**  
**INSURANCE AND PENSIONS BUSINESS AND SUPERVISION**

	<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of Man</i>
<i>Number of companies serving non resident customers</i>			
Locally licensed		352	
Licensed overseas		138	
Total:	13		
Of which:			
Captives and commercial Re-insurers	9	347	164
Life assurance funds	4	6	15
Pension funds			
Intermediaries		37	
Insurance managers UK parentage, per cent		77 %	
<i>Scale of business</i>			
Annual gross premium income £bn:		1.94	2.4
(a) Commercial			0.9
(b) Life assurance & pensions		?	1.5
UK parent companies’ share			
Life Fund assets, £ bn			
Pension Fund assets “			
		72.5%	

		6.5	7
<i>Staff</i>			
Employed in the industry Of which: Commercial Life Assurance & pension funds Insurance and Pensions Managers Intermediaries -A-		720	1,657
Regulator staff, ETEs Of which: Commercial Life assurance & Pensions	314	7	5
<i>Supervisory ratios (per regulator staff member)</i>			
Commercial companies: nos Life & Pension Funds: nos Commercial companies: staff Life & Pension funds: Staff Premium income, £ bn Assets, £ bn	9 4	69	36
		130	352
			0.48
		0.26 0.93 1.4	

## 10 COMPANIES

### 10.1 *Introduction*

The Crown Dependencies, like other offshore centres, have developed large businesses a international company registration and administration centres. About 100,000 companies are incorporated in the Islands. The vast majority are private companies. The corresponding figures for the British Virgin Islands and Gibraltar are 145,000 and 20,000 respectively. These figure compare with about 1 million non-dormant companies on the UK's registers.

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

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

### 10.2 *Nature of the Island company sectors*

The Islands' company sectors differ markedly from those of the onshore jurisdictions. Most companies registered or operating there are owned by non-resident individuals, trusts or companies conducting business or holding assets outside the Islands. Conventional trading companies are very much a minority.

The companies owned by individuals overseas or by trusts are mainly convenient vehicles for holding wealth of various kinds, such as real estate, works of art, yachts, share portfolios, business interests or other investments. Such companies often form part of a pyramid structure, with a Trust at the top owning a variety of separate companies which in turn may own trading companies. These structures may enable individuals to enjoy simultaneously the benefits of trust and company vehicles. The benefits are likely to include confidentiality and tax advantages, depending on the beneficiaries' residence, domicile and local tax regimes, as well as limited liability. The company format also enables individuals or Trusts to segregate assets into separate, self-contained parcels and thus to give separate legal identity to individual parcels of wealth or business interests.

For multinational or overseas companies, the Islands' company vehicles may offer substantial advantages in tax savings and convenience. Such companies may find these vehicles advantageous for headquarters and treasury functions, international trading functions, captive and life insurance business, pensions and share options business, and leasing and investment business as well as asset holding.

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

In the larger countries, such as the UK, there are many organisations providing similar services, including facilities for incorporating companies in any international centre of the client's choice. Many of the CSPs in the Islands are branches of these multi-national CSPs. But they are not a dominant force in the company sector in the same way as in the Islands.

### 10.3 *Policy objectives*

The Islands have all set out to build up businesses as international company registration and administration centres. The Isle of Man has given special priority to this activity. Jersey and Guernsey have adopted a more selective approach.

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

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

### 10.4 *Company law*

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

### 10.5 *Registration and regulation: UK model*

In the UK, there are no restrictions on who may form or register a company. Company registration and regulation systems are designed with the following objectives (among others) in mind:

For companies *incorporated in (the UK but doing business there)*, the requirements are similar. These "overseas" companies too appear on the public register of companies. The disclosure format requirements are, however, less prescriptive and there is no audit requirement.

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

### 10.6 *Registration and regulation: Island models*

In the Islands, the broad objectives of company regulation are similar. [But there is less emphasis on reporting to shareholders and prescribed accounting formats]. [Check minimum capital requirements: none in UK for private companies; £50,000 for public companies (£12,500 paid up)]

With regard to the registration and disclosure regimes, there are considerable differences:

First, the authorities in Jersey and Guernsey *vet* applications for new company registrations. The Jersey authorities do this through a Control of Borrowing Order which provides relevant statutory powers. The Guernsey authorities have a requirement that all applications for company formations must be made to the Royal Court through

Advocates, who are responsible for due diligence investigations” of the applicants. In the Isle of Man, on the other hand, as in the UK, registration is automatic provided that the necessary documentation and fees are provided [and there is no longer a requirement to lodge detailed Memorandums and Articles of Association].

Second, the Jersey and Guernsey authorities require some *confidential disclosures* to the authorities as well as public disclosures. In particular, they require companies to identify who the *beneficial owners* are in cases where these differ from the nominal owners and to notify any subsequent changes (though enforcement may be problematic). The Isle of Man authorities do not make this requirement.

Third, the Jersey and Guernsey authorities have not in the past required *companies administered or operating in the Islands but Incorporated elsewhere* to register or to file any details. The Isle of Man authorities do require such companies to be registered on a separate register known as the F Register. They are required to lodge basic details of Memorandum and Articles, the Directors and the Secretary, and the Company’s authorised local agent.

Fourth, while [all the Islands require companies to produce *annual audited accounts*], there is no requirement to file them publicly and the requirement is not in practice enforced. Neither is there any requirement for an *Annual Report* by the Directors.

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

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

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

- (a) the Company’s name, the address of its registered office and the nature of its business;
- (b) the Company’s Memorandum and Articles of Association, including particulars of share capital and any subsequent changes;

- (c) the names and addresses of the Directors and Secretary of the company, including “Shadow” Directors (if any) who give instructions or directions to the Directors;
- (d) the place where the register of the Company’s members and debenture holders may be inspected;
- (e) in the case of limited companies, annual filing of audited accounts in a prescribed format (abbreviated for small companies);
- (f) an annual report by the Directors reviewing the development of the company’s business and its principal activities

### 10.7 Vetting of Registrations

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

But the case in favour of vetting seems to me very strong. In this as in other areas of regulation, there is much to be said for nipping potential problems in the bud. Stopping companies from registering in the first place seems easier and better than allowing them to register and then trying to identify and de-register them subsequently.

I would therefore support the approach that Jersey and Guernsey have adopted. The case for vetting is especially compelling, perhaps, in centres where the pressures on resources limit the amount of new business that can be taken on.

### 10.8 *Beneficial ownership*

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

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

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

The case in favour of requiring confidential disclosure of beneficial ownership is:

First, the “know your customer” principle. The authorities in a well-regulated finance centre need to know who the principals behind the businesses using the centre are. That



is why there is a requirement to disclose the Directors of companies. If the Directors are not the real principals, the real principals should be known as well.

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

- Third, information about beneficial ownership is likely to be valuable in constructing databases of Island enterprises and the connections between them and as a cross-check on the diligence of service providers.
- Fourth, this information will be especially relevant should there ever be criminal or money laundering trails to investigate.

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

The case against requiring disclosure of beneficial ownership is

First, the requirement may reduce business, including reputable as well as disreputable business. But Jersey and Guernsey have both succeeded in coupling a requirement for confidential declaration of beneficial ownership with substantial company incorporation businesses.

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

Third, as the Isle of Man authorities have represented to me, unscrupulous people are likely to misrepresent or (more likely) fail to declare the beneficial ownership even if there is a disclosure requirement. Asking them to declare it may only encourage them to multiply the layers of concealment. There may be some truth in this, too. But the last point in the preceding paragraph is perhaps the more compelling argument.

In my opinion, disclosure of beneficial ownership should be seen as best practice. It would clearly be best if *all* finance centres made this a requirement.

If particular centres feel unable to go this far, the next best option is to require the corporate service providers to obtain and file the information, as the Isle of Man authorities have proposed.

The third-best option is to require the corporate service providers to ensure that those who asked them to establish the company are reputable and that either they or those by whom they in turn were instructed know the identity of the beneficial owner. This is the model adopted in some of the British Caribbean territories.

10.9 Companies operating on the Islands but incorporated elsewhere

Neither the Jersey nor the Guernsey authorities have in the past required companies administered or otherwise operating in the Islands, but incorporated elsewhere, to register with the authorities at all. There appear to be many such companies. Although the Islands' tax authorities may have some details of these companies, the company registration authorities have none and are generally unable, therefore, to assist the authorities in other countries who make enquiries about them.

In the Isle of Man, such companies are required to file basic information on a separate "F" register. There is some chance, therefore, of pursuing trails through these companies in case of need. But the information required is minimal. It does not include beneficial ownership, country of incorporation or nature of the business.

The Island authorities now feel that they cannot afford to know nothing about companies in this category. There is general agreement, therefore, that such companies should be subject to registration and disclosure regimes similar to those for locally incorporated companies. In my opinion, this is entirely right.

#### *10.10 Disclosure of Accounts and requirements for audit*

There has long been a perception in the larger economies that companies which receive the benefits of limited liability should be expected, as a quid pro quo, to disclose financial information. Customers, suppliers, staff, shareholders, investors and lenders planning to do business with the company have been seen as having a legitimate interest in knowing what assets base and earnings the company has and publication has been seen as the best means of meeting such needs.

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

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

In the Crown Dependencies, as in other offshore centres, the requirements to disclose financial information are very limited. In Jersey and the Isle of Man, only public companies (a small minority) are required to file accounts. In Guernsey, no companies are required to do so. Many people wishing to set up company vehicles are attracted by the lighter disclosure requirements, which enable them to keep their affairs more confidential as well as reducing workload. Offshore centres are generally reluctant to impose such requirements for fear of losing business.

In the Isle of Man, all companies are required to have audited accounts but the requirement is

not enforced. In Guernsey, the requirement is limited to companies other than dormant or asset holding companies. In Alderney, the shareholders are allowed to agree that a company need not be audited. In Jersey [These requirements are not, however, enforced.]

In my opinion there is a presumption, in this as in other areas, in favour of conforming to EU standards in the Islands.

On this basis, all limited companies would be required both to prepare and to file audited accounts. In recognition of the special character of the Islands' company sectors, however, non-trading, asset-holding companies as well as small companies might be permitted to file much abbreviated accounts.

It may be argued that the requirement to prepare audited accounts is more important than the requirement to file them publicly.

In principle I agree with this. It is clearly unsatisfactory, however, to have a requirement for preparation of audited accounts which is not enforced and is in practice quite widely neglected. Several of my correspondents in the Islands told me that this was the practical reality. A requirement to file accounts, even a single-page summary, is much the best way to enforce the requirement to keep audited accounts.

#### *10.11 Regulatory priorities*

The Island authorities are concerned to take all reasonable steps to minimise the scope for abuse of the facilities they offer for companies to be incorporated in the Islands and/or to carry on business there. They are also concerned, quite understandably so, not to proceed in ways which would drastically reduce their companies business and hence their earnings from their Finance Centres.

With these objectives in mind, the authorities in each Island have given priority to developing new policies for the licensing and regulation of company service providers. As mentioned earlier, these service providers play a key role in the Islands' companies business. In my opinion, therefore, the Island authorities have been right to give priority to this area. Chapter 12 discusses at some length the regulation of corporate and trust services providers.

Important as the licensing and regulation of service providers undoubtedly is, it will not in my opinion be sufficient in itself. If the Island company sectors are to be well-regulated, the authorities will also need to introduce or to continue, as the case may be, the good practices discussed above on vetting, beneficial ownership and registration of companies with local operations but incorporated elsewhere.

The requirements for audited accounts and disclosure of financial information (abbreviated for most companies) are likewise important elements in good practice which would ideally be introduced as part of a common initiative by offshore centres.

#### *10.12 Companies by tax status*

In contrast with the larger countries, but in common with other offshore or quasi -offshore centres, the Islands offer various options for special company tax regimes designed to attract international business and the related fees. Companies can therefore be analysed by tax status

as well as by regulatory status.

Although there are differences of terminology and detail between the Islands, there are three main tax categories of company in each of them, one designed for local businesses and asset holders, one for non-resident asset holders and one for non-resident-owned international business:

- *Resident income tax companies.* Companies in this category include most local businesses. They pay tax at 20 per cent on their income. Dividends and interest, apart from deposit interest, are subject to a withholding tax of 20 per cent, which is credited against income tax liability.
- *Exempt or Tax exempt companies.* These are primarily designed as investment vehicles for wealthy individuals, insurance companies or collective investment schemes from overseas. Wealthy individuals overseas (or the trusts they have established) may hold assets of any kind in these vehicles, including physical assets, investment portfolios, business interests or intellectual property rights. Familiar in other offshore centres, too, they account for the majority of Island companies. They may be registered either in the Islands or overseas but must be beneficially owned by non-residents. If they are registered overseas, a significant element of management or control in the Islands is required (the details varying from Island to Island). Board meetings may be held in the Islands. These companies pay a flat-rate annual fee of between £300 and £600. In return for this, they are exempted from income and withholding taxes (except on any local non-interest income). There are no capital gains or inheritance taxes on the Islands.

*International or International Business Companies (IBCs).* These are special vehicles, familiar in all offshore centres, designed to help international or overseas companies to minimise their world-wide tax burden. Each of the Islands has (between 100 and 150) such companies. The vehicles are typically used by international groups for purposes such as head office and treasury functions or by insurance companies. Like exempt companies, IBCs may be registered either in the Islands or overseas but must be beneficially owned by non-residents and engage in overseas business. They negotiate with the Island authorities a rate of tax, usually between 0 and 2 per cent but sometimes substantially higher, which will minimise their parent company's world-wide tax burden. In the Isle of Man, there is also a flat-rate fee option.

The larger countries tend to see such vehicles as facilitating tax avoidance in their own jurisdictions. Other countries, however, including offshore centres, have argued that the issues are by no means straightforward. For offshore centres in particular, these vehicles are an important source of earnings. Individual centres compete with each other for the business.

These issues lie beyond the scope of the present report. In my opinion, they will have to be discussed and resolved at an international level. [The Islands have made clear, rightly in my view, that they wish to play a full and constructive part in such discussions.]

### 10.13 Bearer shares

The Islands vary in their approach to bearer shares. The Isle of Man permits them. Guernsey does not. Jersey does not permit them for Jersey-incorporated companies but companies

registered elsewhere may have them.

In the UK, companies are permitted under the Companies Act 1985 to issue share warrants which resemble bearer shares. The bearer of the warrant is entitled to the share specified in it and title passes by delivery of the warrant. In practice, however, bearer securities have never been popular with English investors or companies and are mainly issued for bonds rather than shares.

In my opinion, there is a presumption against permitting bearer shares. Such instruments enable the unscrupulous to conceal their ownership of companies without offering any significant compensating advantages.

#### *10.14 Insolvency, bankruptcy and inspectors*

In any well-regulated finance sector, a good legal and regulatory framework for insolvency and bankruptcy is an essential ingredient .....

(Section still to be drafted.)

In addition to these main types of company, Jersey and the Isle of Man have some special categories.

Jersey has a special category of *foreign registered investment companies*. [For whom are these designed?] These companies pay no taxes or fees at all, provided that at least one Director is resident in Jersey. In contrast with foreign registered exempt companies, they are not required to disclose their beneficial ownership to the Jersey Tax authorities. [As the Jersey authorities recognise, however, there are risks in hosting business about which they have no knowledge.]

The Isle of Man has a special category of *non-resident companies*. These companies are incorporated in the Island and have therefore to submit a limited amount of basic information at the time of registration. But in return for declaring that all their business is controlled and conducted outside the Island (and that all their Directors are from outside the Island) they qualify as non-resident for tax purposes. This means that they have no liability to tax in the Island beyond the flat-rate non-resident company duty of [*£750*] a year. The administrators of such companies typically engage Directors in Sark or other tax-free locations so as to make them resident for tax purposes in such locations. In return for a slightly higher fee, therefore, and with the help of Sark (or other) Directors who in many cases appear to have no knowledge of the company's activities, the owner of the company is able to escape tax altogether and to hide other activities of the company. As with other Isle of Man companies, there is no requirement to disclose beneficial ownership.

This category of company, when used in the way described, appears to have two troublesome features. The first is the use of bogus Directors, not playing any genuine part in running the company) to create the fiction that the company is controlled in Sark or other tax-free locations. Chapter 11 discusses this aspect further. The second is the secrecy about the company's ownership, activities and finances. Whatever the original intention behind this category of company may have been, these two features, taken together, make this a perfect vehicle for enabling beneficial owners to evade taxes in their own home-jurisdictions and to mask other forms of disreputable activity.

[The Isle of Man authorities are considering the case for abolishing this category of company. I am sure they will be right to do so.] [OR Several of those whom I consulted on the Island thought that this category of company should be abolished. I agree with them.]

In recent international discussions, the larger industrial countries in the Group of 7 and 8 and the OECD have raised the question whether offering preferential company tax vehicles along the lines described in this section to non-residents constitutes harmful tax competition.

## BANKING BUSINESS AND SUPERVISION

### *Number c/licensed banks*

Total

Of which:

Subsidiaries

“Managed” banks

Home supervisor responsibilities

*Scale c/business*

Total liabilities, £ bn

Average liabilities per bank, £ bn

£ liabilities, % of total

Liabilities to UK residents, £ bn

Assets invested in UK, £ bn

**4**

Bank staff

Regulator staff FTEs

*Supervision ratios* (per regulator staff member)

Deposits, £ bn

Banks

Bank staff

### **REVISED 10.14**      *Insolvency and bankruptcy: existing regimes*

The remaining sections of this chapter draw heavily on a review of the bankruptcy and insolvency regimes in the Islands commissioned by the Home Office. at my request from Mr Guy Sears. I am most grateful to Mr Scars.

All the Islands have well established regimes for dealing with bankruptcies and corporate insolvencies

Jersey has a unified modern procedure, known as desastre, for persons and companies, and separate modern procedures for winding up companies

Guernsey has old Laws dealing with bankruptcy of individuals and insolvency of partnerships and a more modern law, dating from 1994, on company insolvencies, based on the UK’s Insolvency Act 1986

The Isle of Man has old legislation, based on still older UK legislation, on bankruptcy and corporate insolvency. A working party in 1994 recommended new *legislation incorporating a range* of reforms. The authorities hope to *bring forward* an Insolvency Bill in the next session of the Island's Parliament.

As in other jurisdictions, the *Islands'* regimes for bankruptcy and insolvency take the distribution of assets out of the debtor's hands.

#### *10.15 Insolvency and bankruptcy: main issues*

Mr Seats has made two main proposals for improving the islands' bankruptcy and insolvency regimes:

##### *(a) Rescue procedures*

With some limited exceptions in Jersey, none of the Islands has modern procedures for enabling businesses to be rescued, in appropriate cases, rather than made insolvent. There are no procedures comparable to administration in England.

Mr Sears has suggested that the authorities in all the islands would do well to bring in a new regime allowing companies to obtain a moratorium on action by creditors for (say) 28 days. Within that period rescue proposals could be made which if approved by a requisite majority of creditors could bind the creditors as a whole.

The UK authorities have consulted about such a proposal but have not yet resolved how it could be implemented alongside floating charges and administrative receivers. The Isle of Man (whose 1994 working party recommended such a procedure) would have a similar problem in relation to floating charges

For Jersey and Guernsey, introduction of the procedure would be relatively straightforward. As discussed in Chapter 7, the Guernsey authorities would have found such procedures invaluable in the Barings Bank collapse of 1994.

##### *(b) Official Receiver. or equivalent*

The public interest sometimes requires that companies be put out of business even though no private sector person is willing to take the initiative in making it happen. The requirement may arise because the companies are insolvent or for other reasons

In all jurisdictions, therefore, suitably constituted public bodies are needed with responsibilities, powers and means to investigate any such companies and petition the Courts to wind them up in the public interest.

Also needed are implementing bodies which carry *through the practical business of insolvency in the public interest* where the situation so demands (for example, Where no assets are available to finance private liquidators).

Without bodies of both kinds, or bodies which combine both functions, there is a risk that no one will wish, or no one will have the locus or the money, to wind the companies up, disqualify Directors or return assets to creditors. The bodies need to have means as well as powers, including access to public funds.

In Jersey, the Viscount's office includes among its responsibilities the implementing function described. The Viscount has the powers and means to discharge this function. The Isle of Man and Guernsey do not at present have any corresponding body. The [Isle of Man authorities] ] authorities in both Islands] do, however, have plans to introduce an official Receiver on English lines

The public body concerned should preferably have responsibility for two related matters, both identified by Mr Sears:

*Ascertaining access so assets held in Trust* The body should be responsible (as the Viscount in Jersey already is) for asking the Courts in appropriate cases to direct how Trusts assets (not normally available to creditors) should be applied as well as for dealing with distribution of the other assets

*Licensing and supervision of insolvency practitioners.* Self-regulation for insolvency practitioners seems to me a less good alternative in jurisdictions such as the Islands where practitioners tend to come from different backgrounds.

The FSCs, too, should have powers to ask the Courts to wind up any company, whether licensed or not, carrying on an activity for which a licence is needed. Anyone who brings an insolvency application against licensed firms (or firms which ought to be licensed) should also be obliged to inform the FSCs

In my opinion, the authorities in Guernsey and the Isle of Man will be well-advised to include the full range of powers described above in the proposals they have for updating their insolvency regimes and legislation.

#### *10.16 Insolvency and bankruptcy: other issues*

Some other issues examined by Mr Sears were

*Universality and non-discrimination.* In all the Islands, insolvency orders apply to all assets wherever located. There is likewise no discrimination between; domestic and overseas creditors.

*Set-off* The Islands have differing but reasonable provisions for setting off mutual debts and credits.

*Discharge period.* Guernsey law does not provide for a fixed discharge period for people declared bankrupt. A period of between 2 and 4 years would be normal



*Partnerships.* The procedures for insolvency of partnerships in Guernsey are somewhat dated. Partnerships should preferably be treated for this purpose like companies

*Transaction prior to bankruptcy or corporate insolvency.* The Isle of Man and Guernsey provisions for setting these aside could usefully be updated.

*Overseas companies.* The Jersey and Isle of Man authorities, like the UK, have powers to wind up overseas companies In Guernsey, the FSC *can* wind up overseas banks and insurance companies but not overseas investment or other companies.

*Licensing of insolvency practitioners.* The requirements vary between the Islands. As discussed above, licensing by the office of the Official Receiver or equivalent has much to commend it

Redress against liquidators and others. In all the Islands, the Courts can remove from office the corporate liquidator, the trustee in bankruptcy or other office holders. Aggrieved persons can sue them for breach of duty or misapplication of assets The Courts would preferably have Powys, too, to investigate the actions of liquidators and other office holders and oblige them on a summary basis to pay or account

Disqualification of Directors, Directors can be called to account or disqualified

in all the Islands As discussed in chapter 11. however, these provisions are under-used and under-funded

*Information from debtors* [The Islands appear to have no equivalent to the UK provisions requiring debtors and other relevant persons to give information to the Court]

Wrongful Trading. The Isle of Man does not at present have wrongful trading provisions but proposes to introduce them in the forthcoming Bill

*Shadow Directors.* Shadow Directors, from whom the Directors take instructions, may be held liable along with the Directors for wrongful trading in Guernsey and, by implication, in Jersey. The Isle of Man does not at present have such a provision

*Provisional liquidators,* These can be appointed in Guernsey and the Isle of Man to prevent dissipation of assets. In all the Islands, Mareva-style injunctions can be issued.

*Mutual recognition of insolvency order.* In Jersey and Guernsey the judicial authorities have statutory obligations to recognise insolvency orders and folic holders in the UK and in other named jurisdictions where there are arrangements for mutual recognition In the Isle of Man, such recognition is limited to bankruptcy cases. In all the Islands, the common

law allows for recognition of orders from other jurisdictions on the usual grounds of comity.

The Island authorities may wish to consider this checklist of points, as well as the major issues on moratoriums and official receivers discussed earlier, when updating their insolvency and bankruptcy regimes

## 11 DIRECTORS AND PARTNERSHIPS

### 11.1 *Directors and disqualification*

As in the UK, the Company legislation in all the Islands lays certain duties and obligations on Directors of companies incorporated in the Islands.

The Courts have powers to disqualify people from acting as Directors for significant periods of years, [?though these powers do not at present extend to Directorships of companies incorporated outside the Islands.] The grounds for disqualification and the penalties vary somewhat from Island to Island:

In *Jersey*, the Royal Court has power to disqualify people [?only in the event of insolvency or bankruptcy]. There are no set criteria for disqualification. The maximum disqualification period in bankruptcy cases is 15 years. There are proposals to introduce the same maximum period in insolvency cases.

In *Guernsey*, the Court may prevent a person from acting as a Director or officer of a company for up to 5 years if satisfied that this is in the public interest. The powers are not limited to cases of bankruptcy or insolvency.

- In the *Isle of Man*, the Court may disqualify Directors for up to 5 years if they are judged unfit on the basis of specific criteria set out in the legislation. Here, too, the powers are not limited to cases of bankruptcy or insolvency.

In practice, no Directors have so far been disqualified in either Guernsey or the Isle of Man. The Royal Court in Jersey has disqualified three persons under the bankruptcy law

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

In all three Islands [? Guernsey too], Directors are able to delegate all or any of their powers by Power of Attorney. This resembles the position in the UK except that in the UK the Directors remain responsible and liable even so.

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

The legislation needs to

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

- make provision for a Code of Conduct for Directors;
- give the authorities wide powers, not confined to insolvency or bankruptcy cases, to disqualify Directors;

extend to Directors of companies operating on the Islands but not incorporated there.

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

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

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

### 11.2 “Nominee Directors” and the “Sark Lark”

The reputation of all the Islands has suffered in recent years from the presence on the Islands, especially Sark, of so-called “nominee” Directors. The problem has come to be known as the “Sark Lark”. But “nominee” Directors are apparently found, to a lesser extent, in other centres as well.

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

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

3 residents appeared to hold between 1600 and 3000 Directorships each;

a further 16 residents appeared each to hold more than 135 Directorships each; and

a further 30 residents appeared each to hold between 15 and 100 Directorships

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

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

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

In the case of Sark, more than three-quarters of the total Directorships held by Sark residents last autumn, about 11,350 out of 15,000, were with non-resident companies registered in the isle of Man. The rest were mostly with companies registered in the UK, Ireland and Panama.

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

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

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

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

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

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

Another facet of the problem has been that some companies have sought to establish by means of false addresses that they are resident in Sark when they are not. The Guernsey authorities recently brought in legislation to deal with this [reference]. The new legislation makes it an offence to misrepresent where a company or person is resident. It would now be an offence, therefore, to pretend that a company's Directors are resident in Sark when they are not.

As the Guernsey and Sark authorities recognise, however, the main problem has still to be solved. People on Sark and the other Islands are still able to act as 'nominee' Directors of companies about which they know little or nothing. They can do this, moreover, without any misrepresentation of domicile. A case now before the Courts in England indicates that

acceptance of such Directorships may expose those concerned to greater risks of litigation than previously foreseen. But a full solution will require further legislation and a measure of regulation.

In theory the problem could be solved by means of action in other jurisdictions, across the world, to remove the demand for 'nominee' Directors in Sark and other low-tax jurisdictions. Changes in the Isle of Man's rules for the regulation and taxation of companies registered there, for example, could choke off the business associated with Isle of Man companies. Even if the Isle of Man authorities take such action, however, as discussed in section 10. 10, the demand for 'nominee' Directors will probably not disappear. Other finance centres willing to host such schemes will probably be found.

The authorities in Guernsey, Alderney and Sark are agreed, therefore, that the 'Sark Lark' problem must be solved by means of new legislation with application throughout the three Islands. The legislation would not prohibit Sark residents from acting as Directors but would enable (and oblige) the Guernsey authorities to regulate those who provide Director services anywhere in the three Islands.

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

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

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

- (a) to know who owns the company they direct;
- (b) to know what its business is;
- (c) to know what its finances are.,
- (d) to ensure that the company is not trading wrongfully or breaking the law in other ways;
- (e) to ensure that its tax arrangements would remain sustainable if publicly known; and
- (f) not to duck these general responsibilities by assigning them to others.

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

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

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

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

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

The representatives of Guernsey, Alderney and Sark whom I met all seemed fully committed to finding an early solution along these lines. I am sure they will be right to do so. The Guernsey authorities propose to legislate for this ahead of the other legislation they are planning for the regulation of fiduciaries. Their aim is to have the new law and regulation in place by September 1998,

### 11.3 Partnerships and Limited Partnerships

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

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

The Islands created legal frameworks for local registration of limited partnerships in 1995. Before that such partnerships were registered abroad, mostly in Delaware. Jersey now has 107, Guernsey 53 and the Isle of Man 51.

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

Full details of the partnerships have to be registered with the authorities. In all the Islands the authorities have discretion whether or not to allow their formation. The general Partner may need to be licensed under the investment business regulatory regimes. Otherwise, there is no on-going supervision.

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

#### 11.4 Limited liability partnerships and LLCs

Only Jersey has so far introduced legislation for Limited Liability Partnerships on North American lines. [What kind of enterprises are expected to use these vehicles?]

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

As with private companies in Jersey, there will be requirements for [? disclosure of beneficial ownership to the authorities in confidence and] maintenance of proper accounts but not for audit or publication of accounts.

[In my opinion, the Jersey authorities would be well-advised to consider the case for requiring audit and disclosure of accounts for enterprises on this scale. The adequacy or otherwise of the £5 million bond will not otherwise be apparent to others wishing to do business with the partnerships.]

The Isle of Man offers a similar vehicle, somewhat confusingly called the "Limited Liability Company" (LLC). [For whom are these designed?] LLCs are formally companies, with their own legal personality and a life limited to 30 years. But they are taxed like partnerships. Profits are divided among the members and taxed accordingly. There is no requirement to disclose beneficial ownership to the authorities. Like other companies, they are obliged to keep audited accounts. But this requirement is not enforced and there is no requirement to file such accounts.

[The issues which arise on LLCs seem similar to those which arise on companies in the Isle of Man: see the previous chapter.]

## 12 TRUSTS AND TRUSTEES

### 12.1 Introduction

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

### 12.2 Trust frameworks and terminology

In the Islands, as in other jurisdictions where the law makes provision for Trusts on Anglo-American lines, Trusts always involve settlors and trustees.

The settlors are the persons or companies who transfer ownership of their assets to trustees by means of a Trust deed and (usually) a non-legally-binding letter setting out what the settlor wishes to be done with the assets.

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

Most Trusts have beneficiaries other than the settlor and have a maximum life of 100 years. The trustees are obliged to account to the beneficiaries for what they do with the fund. The beneficiaries are then able to enforce implementation of the Trust deed. The settlor may be the sole ' beneficiary. But such an arrangement, known as a resulting trust is quite likely to be disregarded by the Courts as being a sham.

Some Trust deeds give the trustees discretionary powers to use the assets for the benefit of various people who are not beneficiaries. Such people are known as objects of a power of appointment rather than beneficiaries. They often do not have the same rights as beneficiaries to hold the trustees to account. In some jurisdictions, Trusts are permitted to have only objects of a power (until some person becomes entitled as beneficiary on expiry of the Trust period) and the objects have no right to be informed that they are objects. This is known as a blackhole trust.

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

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

The Cayman Islands have taken the further step of bringing in new legislation for Special Trusts Alternative Regime (STAR) Trusts of unlimited duration whose beneficiaries have no enforceable rights against trustees, enforcers or Trust property. In the Crown Dependencies, as in the UK, such Trusts would be ineffective.

### 12.3 Scale

Trusts are a key element in the Islands' international finance centres. A high proportion of the total business involves the use of Trusts in one form or another. The Trust and company vehicles taken together enable them to offer a range of facilities not generally, available in civilian or Muslim law finance centres, offshore or onshore.

The Islands, like the UK, do not register Trusts (other than regulated categories such as Unit Trusts). Hence the number of Trusts and the value of assets held in them are unknown. The Jersey authorities believe, however, that Jersey Trusts probably hold assets in excess of £100 billion. The Guernsey authorities believe that the corresponding figure for Guernsey may be



£20 billion. A survey conducted in 1995 suggested that only one quarter of the 26,000 Guernsey administered Trusts covered by the survey were for UK clients.

#### 12.4 Scope and purposes

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

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

to have some continuing influence, via the trustees and the Trust deed, over what happens to their assets after their death;

to prevent the assets being squandered by lazy or spendthrift heirs or misused by mentally handicapped heirs;

to keep assets or properties together rather than have them sold or dispersed into small parcels;

to avoid forced heirship rules in various parts of the world.,

to avoid probate problems, which can be horrendous for persons with assets in several jurisdictions; and quite possibly

to reduce tax liabilities.

Some offshore centres have introduced legislation to permit so-called Asset Protection Trusts, designed to improve protection for the settlor's assets against creditors, awards of damages or suits by estranged spouses. The Crown Dependencies, however, have no such legislation. The Island Courts would be expected to set aside Trusts set up to prejudice foreseen creditors, though not (as in the UK) unforeseen future creditors,

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

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

- Pension Fund Trusts
- Employee share ownership Trusts
- Unit Trusts

Debenture Trusts for bondholders

Securitisation Trusts for balance sheet reconstructions

Client account Trusts for lawyers and other providers of professional services, separate from the providers' own assets

Future income stream Trusts

Subordinated creditor Trusts

Retention fund Trusts, pending completion of contracted work

## Sinking Funds.

In each of these cases, the Trust instrument offers the parties concerned a convenient solution to problems which would otherwise be highly intractable.

### 12.5 Special advantages of Island Trusts

Compared with the major onshore finance centres, the Islands' major advantage is that they are able to offer a favourable tax environment:

Non-resident Trusts (that is, Trusts with non-resident beneficiaries) do not pay income tax or any other tax in the Islands.

Both resident (corporate) and non-resident Trusts may gain from using the special International Business Company and Exempt Company tax vehicles, or equivalents, described in Chapter 10.

Any resident Trusts that are subject to tax will be taxed at 20 per cent on income and there are no capital gains or inheritance taxes.

As discussed in Chapter 10, substantial company structures owned by a Trust are quite common in the Islands. I was told that in Jersey perhaps 80 to 90 per cent of Trusts have corporate structures beneath them.

Where non-residents disclose details of their Trusts to their home authorities, the tax advantages will depend among other things on the tax regime in the home country. The UK introduced measures in 1991 and again in 1998 which largely remove any tax advantage for UK residents in having family Trusts overseas. Other countries have different tax regimes. For expatriates of most countries, the offshore Trust, company and banking facilities are likely to offer substantial advantages.

Other possible advantages the Islands may have compared with the main onshore centres are: .

the reassurance, in Jersey and Guernsey, of having a visible and generally attractive Trust statute to supplement case law; and

the availability of non-charitable purpose Trusts in Jersey and the Isle of Man.

Compared with other offshore centres, the Islands benefit from their reputation for competence, honesty and confidentiality. This must be attractive to those who wish to spread their risks between jurisdictions.

### 12.6 Risks arises

Hugely advantageous as Trust instruments can be, and vital as they have been to the development of London and the Crown Dependencies as international finance centres, the risks too are considerable.

The vast majority of Trusts are probably free from abuses of any kind. But the scope for abuses and scandals is very great. As Trusts age, moreover, the scope for abuses multiplies.

For offshore centres, above all, such abuses and the associated scandals could devastate reputations and business. In the Trust area itself, new business would be especially at risk. Most existing Trusts would probably remain in the Islands, since their trustees are mainly resident; but a protector may exercise a power to "export" a Trust by replacing the existing trustees with trustees from a more highly regarded jurisdiction.

The risks of abuse in Trusts are of two main kinds: risks from crooked settlers and risks from crooked or incompetent trustees.

There are three main kinds of abuses that crooked settlers may attempt:

**Concealment.** They may use Trusts and related company vehicles and bank accounts to conceal assets from creditors, estranged spouses, suitors or tax authorities. Or they may use Trusts, with their related companies and bank accounts, as elements in the elaborate processes for concealing the proceeds of crime of all kinds from police, customs, prosecutors and courts (money laundering).

**Protection.** They may use Trusts to try to put their assets, even if discovered, beyond the reach of the same groups of pursuers: creditors, estranged spouses, suitors, tax authorities, police, customs, prosecutors and courts.

To reinforce the protection given by the Trust itself, they may include in the Trust deed 'flee clauses' providing that new trustees in a new jurisdiction with a new law will take over automatically when any of a specified range of events occur, such as prosecution or service of a writ on the former trustees. To facilitate this, they may arrange for the assets to be held in another jurisdiction again.

**Sham Trusts.** They may have an arrangement with the trustees whereby the trustees recognise that the assets remain the settlor's in all but name and that their task as trustees is to do exactly as the settlor says. So the Trust is bogus or sham.

No less serious are the risks of abuses by trustees. The vast majority of trustees are probably honest, competent and conscientious. But those who are not will sometimes have scope for being dishonest or negligent without much risk of being found out. Potential abuses include:

**Stealing.** The trustees may be in a position to transfer assets from the Trust account or one of the companies owned by the Trust to their own accounts, or one of their own companies, either directly or (more probably) via other intermediate accounts. Such transfers will be easier if there is no obligation to keep and disclose audited accounts, either for Trusts or for companies. The truth may not come out until long into the next century, when the Trust expires, and perhaps not even then.

**Fees.** More simply and safely, the trustees may be in a position to bill the Trust fund for exorbitant fees or non-existent or unnecessary services. This too will be much easier if there is no obligation to keep and disclose audited accounts.

Negligence or incompetence over investments. They may mishandle the investments, through negligence or incompetence.

Failure to carry out the terms of the Trust deed. They may fail to carry out the terms of the Trust deed and/or the settlor's letter of wishes in the uses they make (or fail to make) of the Trust's assets.

As implied above, these abuses are much more likely to occur if the trustees are not properly accountable to anyone. There are two particular ways in which accountability may fail-

Non-disclosure to beneficiaries and objects. In most Trusts the beneficiaries or the objects of a discretionary power (as defined earlier) will have both the incentive and the locus to call the trustees to account. This is the principal and traditional means for ensuring that trustees act honestly, properly and competently.

In some cases, however, some at least of the beneficiaries may not know that they are beneficiaries. Disreputable trustees may take the (limited) risk of failing to tell them. More often, perhaps, they may know that they are beneficiaries but the trustees may not keep them properly informed about the Trust's affairs and assets and their stewardship of them.

In other cases, no beneficiaries may be ascertainable until expiry of the Trust period. In such cases there may be objects of a power but the trustees may not accept any obligation to tell any of them that they are the objects of a power. They may not know, therefore, that they stand to benefit from the Trust.

In all such cases, the trustees may not be properly and effectively accountable to anyone. Especially once the settlor is dead, and the beneficiaries or objects are two or three generations removed from the settlor, the possibilities for abuse multiply.

No proper audited accounts. Trustees are always obliged to produce accounts for beneficiaries on request. But they may not be under any obligation to produce (or preserve) audited accounts or submit them to anyone unless the settlers have stipulated this in the Trust deed or letters of wishes.

## 12.7 Existing legislation and regulation

In the course of my consultations, I found general agreement that, for the most part, the Islands have as good a legal framework for Trusts as any other jurisdictions, and better than most.

Despite some differences of history and substance, the framework is broadly similar to that in the United Kingdom. The legal basis in the Isle of Man, as in England, is equitable law. In Jersey and Guernsey, Trust Law has since the 1980s had a mainly statutory basis. Jersey codified existing practice in Jersey and England in a Trusts (Jersey) Law 1984. Guernsey passed a similar Trusts (Guernsey) Law in 1989, amended in 1990.

In all the Islands, there have been significant legal cases concerning Trusts and fiduciary responsibilities. These have confirmed that the Islands' judiciaries are well qualified and able to deal with such matters.

As in the UK, but in contrast with the UK's Caribbean finance centres, the Trusts sector in the Islands is not at present subject to regulation or supervision. Individual categories of business with a Trust dimension, notably Pension Funds, Unit Trusts and certain other kinds of investment business, are subject to the regulatory regimes for those areas. But there is no general regulation of Trusts or trustees.

## 12.8 Possible improvements to existing legislation

Professor David Hayton has identified a number of possible improvements that might be considered in the Islands' Trust legislation.

To counter potential abuses by settlors, he has suggested the following provisions

- Defrauding creditors.

(a) As in England, a settlor should not be allowed by means of a Protective Trust created in favour of himself to protect his assets against creditors if he goes bankrupt at any time in the future. At such time, the settled property should, as in the UK, pass to his trustee in bankruptcy.

(b) Again as in England, any Trust intended to prejudice the settlor's future unascertained creditors should be allowed to be set aside by such creditors for the first 5 or 10 years of its life. Such Trusts could include, for example, discretionary Trusts in favour of the settlor, his spouse and their descendants.

(c) When non-resident settlors go bankrupt, their creditors should have the same ability to recover assets as they have from Island-resident settlors.

Frustrating legitimate claims of heirs and spouses. As in England, Courts should have powers to set aside:

(a) Trust (or other) arrangements made by locally domiciled settlors up to 6 years before their death to defeat the legitimate claims or expectations of family or dependants under mandatory family protection rules, and

(b) similar arrangements made to defeat financial claims by divorcing spouses under the Islands' divorce jurisdictions, especially where the arrangements were established up to 3 years before the claims are made arrangements (and may thus be presumed to have been made to defeat such claims).

Flee clauses. The legislation could usefully include specific examples of events (such as the bringing of criminal charges or restraint orders) that may not trigger "flee clauses" (providing for automatic replacement of the existing trustees by new trustees in certain eventualities). These would supplement the general power to regard flee clauses as void for public policy reasons. Including specific examples in the legislation would improve the chances of co-operation by overseas jurisdictions when such clauses are triggered for disreputable reasons.

To counter potential abuses by trustees, Professor Hayton has suggested the following provisions:

Number of trustees. As in England, for land at least, sole trustees should never be permitted. To guard against dishonesty and negligence, there should always be at least two individual trustees or a properly constituted Trust provider company. The four-eyes principle can then be applied.

#### Requirements to inform beneficiaries and objects of discretionary powers

(a) The legislation should explicitly require trustees, so far as practicable and except where there are decisive reasons to the contrary, to inform beneficiaries and at least two or three representative objects of a discretionary power that they are beneficiaries and objects, respectively. Without such information, Trusts risk being shams.

(b) Trustees should also be obliged to show beneficiaries and representative objects key documents relating to the Trust, including annual accounts (but not letters of wishes if the settlor explicitly or implicitly intended them to be confidential to himself and the trustees). The legislation should nullify any attempts to remove this right.

Liability of trustees for negligence. The law should prohibit or nullify clauses exempting trustees from liability for negligence of any kind, ordinary or gross (as well as for dishonesty). The Trust Law Committee is recommending such a provision in England. The Turks and Caicos Islands already have one.

Waiver of privilege against self-incrimination. The law (in England as well as the Islands) should require waiver of the privilege against self-incrimination as a condition of all future trusteehips.

Enforcers for Purpose Trusts. If the Islands wish to have Purpose Trusts, they should have legislation as in the Isle of Man's Purpose Trust Act 1996 making such Trusts subject to inspection by the Attorney General, or his representatives, in the role of enforcer. The legislation should make clear that this and other requirements on Purpose Trusts apply equally to Trusts where there is a provision for any residual assets at the end of the Trust period to pass to persons or charities

Professor Hayton has also suggested that, if the Island authorities should introduce an optional registration system for trustees, there could be a requirement for non-registered trustees to obtain independent professional auditing of trust funds in excess of some specified amount. These matters are considered further in a later section.

#### 12.9 Case for regulating Trust service providers

The Island authorities have no proposals to regulate or register Trusts as such. They do all propose, however, to extend the regulatory boundary to include professional providers of Trust and trustee services.

Legislation to this end is due to be introduced within the next [12] months. with a view to implementing the new regimes as early as possible in 2000.

This legislation will also offer a convenient opportunity to enact the other points suggested above by Professor Hayton.

In my opinion, the Island authorities are entirely right to extend the regulatory boundary As discussed above, the scope for abuses in the area of Trusts. as also of Companies, is very great.. The sooner the boundary can be extended, therefore, the better.

The Island authorities are also right, in my opinion, to focus the regulatory regime on Trust service providers rather than Trusts themselves. This is the route which the British Caribbean authorities, too, have followed.

To require the registration and regulation of Trusts, as such, would be an enormous undertaking, comparable with the registration of Companies. It would also be likely to deter customers who wish privacy in their family and personal arrangements.

The better course, therefore, is to extend the regulatory boundary, as proposed, to cover professional providers of trustee and other Trust services, whether in banks, accountancy firms or law firms or independents. This seems to me not only the most economical, but also the most effective, way to regulate the sector, to the extent that regulation is needed.

There are some who say that there is no need to regulate a sector which mainly serves companies and relatively prosperous people. If they choose bad trustees and make bad Trust arrangements, so the argument runs, that is their fault. Provided that there is a satisfactory legal framework, offering the aggrieved the chance of redress, there is no need for regulation.

In my opinion, such arguments are too cavalier. The more persuasive arguments are:

First, the regulatory authorities of intentional finance centres cannot honourably stand idly by if crooked or incompetent people are abusing customers

Second, such abuses, if they occur, may destroy the reputation of a whole industry and finance centre. The expectation has grown, and continues to grow, that international finance centres will be well regulated and will not permit abuse.

Third, a good legal and judicial framework is undoubtedly essential. But such a framework punishes abuse, often at great cost, after it has happened. It is far better to prevent and deter abuse from happening in the first place, through suitable regulation. By the time the Courts are involved, the damage has been done.

The Trust service providers, or their customers, should however be expected to cover the cost of regulation through the providers' registration fee.

## 12. 10            A possible regulatory regime

As in the British Caribbean territories, where Trust service providers have been subject for many years to licensing and a measure of regulation, legislation will be needed to establish the regulatory regime.

In the Caribbean territories, the legislation forms part of the local banking legislation and is drafted with banks rather than Trust service providers primarily in mind. In the Crown

Dependencies the legislation will take the form of a separate Law covering either Trust service providers or, preferably in my view. all Trust and Corporate service providers

The Law will need in my view to cover broadly the following points (a fuller version is in Chapter 13, Box 13. I):

The Financial Services or Supervision Commissions (FSCS) would be tasked to act as registrars and regulators of Trust Service providers.

All professional providers of trustee or other Trust services would be required to apply to the FSCs for registration. It would be an offence to provide such services without registration.

In deciding whether to grant registration, the FSC would be obliged to take all reasonable steps to satisfy itself that the applicants were fit and proper, in terms of integrity, solvency, competence, track record and technical support, and had adequate capital and insurance;

The FSC would draw up with the industry a Code of Conduct with which registered providers would be expected to comply. Some elements in the Code might be given specific statutory effect.

The FSC would have powers to inspect and obtain information from providers for purposes of enforcement and to name, warn and disqualify them if they fail to comply on a continuing basis with the fit and proper tests and the Code of Conduct.

The providers would be obliged to submit annual returns to the FSC, including an audited compliance return and audited accounts.

For the Code of Conduct, there are again some Caribbean precedents, notably the British Virgin Islands' 'Code of Conduct for the performance of licensed members of the Association of Registered Agents', which is about to receive statutory force. The accompanying Box 12.1 summarises the coverage of this Code.

In the Crown Dependencies, the Code could be along similar lines. It would preferably, however, deal more specifically with the key areas of risk and potential abuse associated with Trusts, and the means for dealing with them, including those discussed above:

possible attempts to conceal and protect assets from creditors;

possible attempts to hide the proceeds of crime.

sham Trusts;

custodians, protectors and enforcers;

disclosure of key information to beneficiaries and objects; such information to include annual accounts and fees (independently audited for the larger Trusts).

Box 12.2 gives an illustrative sketch of what a Code for the Crown Dependencies might cover.

It would be possible to have two categories of Trust service providers, registered and unregistered. Settlers would then have the option of employing providers from one group or the other. The problem with this, however, is that unregistered providers could all too easily bring the Islands' finance centres into disrepute. It seems far better, therefore, to require all providers to be registered.



## 12. 11 Issues of transition

The Island authorities recognise that, in this as in other sectors, the transition from nonregulation to regulation will require careful handling.

In my opinion, there are two important considerations which apply to transitions generally.

First, the initial registration process should set high standard's. It should be used to weed out dubious or incompetent providers. The initial process will provide the best opportunity there has ever been, or will ever be, to achieve this without being unfair to anyone. It is far easier not to register in the first place than to remove a registration previously given

Second, the authorities should make clear publicly, well in advance of registration day, how tough the initial registration process will be. This will greatly facilitate the task of weeding out. As with choir auditions, many of the more marginal providers are likely not to apply rather than apply and be turned down. This makes the whole process more manageable and more acceptable.

In the area of Trusts there is a special problem of transition: what happens to the Trusts whose trustees fail to qualify for registration? Clearly some arrangements must be made to ensure that successor trustees are appointed from among the ranks of the registered.

In many cases, this should not present any problems. There may however be Trusts which no other trustees would willingly take over. Some fall-back arrangement, preferably not dependent on Court hearings in each individual case, is likely to be needed.

To deal with such problems, the legislation might provide that after D-day trustees not registered should:

appoint new trustees as soon as practicable from the ranks of the registered trustees with the agreement of protectors and/or enforcers and after informing beneficiaries and objects;

in the absence of volunteers, invite the Attorney General or his appointed representative to assume responsibility for appointing new trustees or temporary trustees;

in the meantime, take no act-Ion on their Trusts other than to preserve Trust properties.

The Attorney Generals and their appointed representatives would need a corresponding power to appoint trustees or temporary trustees at the expense of the Trust concerned and to go to Court in cases of blackhole Trusts or Trusts with no adult beneficiaries.

This, however, is only one approach. The Attorney Generals or their representatives could alternatively take responsibility for providing temporary and then permanent trustees for all the Trusts concerned

## 12.12 Comparison with the UK

As discussed earlier, I am sure that the Island authorities are right to extend the regulatory

boundary to cover providers of Trust services even though the UK has not yet done so.

I hope that the UK authorities will consider extending the regulatory boundary in a similar way.

The considerations that point to taking this step in the Islands may not seem so pressing in the UK. In my opinion, however, they are equally compelling.

A further consideration is that, when the Island authorities carry out their plans, the less reputable providers will tend to move to the UK if the UK makes no matching move.

A valuable by-product of such a step is that it would open the way to create for the first time inside the UK Government, or the Financial Services Authority, a group of people with a clear responsibility for overseeing the Trust sector.

This too is much needed. Some on-going oversight of the sector, and the law that governs it, will help to ensure that the sector realises its potential for good while minimising the risks and abuses described in this Chapter.

Trusts have been and remain a unique and invaluable element in the facilities offered by the Common Law jurisdictions. Without a measure of regulation and oversight, however, they could all too easily fall into disrepute.

## BOX 12.1

### BRITISH VIRGIN ISLANDS (BVI)

#### CODE OF CONDUCT FOR THE PERFORMANCE OF LICENSED MEMBERS OF THE BVI ASSOCIATION OF REGISTERED AGENTS

The new BVI Code covers:

.-, objectives of the Code:

- BVI reputation
  - deter criminals
  - protect members
- monitoring of compliance through an annual audit  
staff training  
relationships with clients, including:

Establishing a suitable paper trail in all cases knowing the clients  
knowing clients' needs and putting their needs first checking that professional service clients are of adequate standing and have suitable due diligence procedures for the beneficial clients  
knowing the identity of end-user clients and obtaining a banker's reference  
protecting client confidentiality  
charging just and proper fees

where fiduciary services are provided, maintaining records and checking that Trust assets are not of criminal origin.

procedures for transfers of clients procedures for disciplining, sanctions and appeals arrangements for modifying the Code.

BOX 12.2

TRUST SERVICE PROVIDERS.

ILLUSTRATIVE SKETCH FOR A CODE OF CONDUCT

Trust Services Providers are required..

· to promote the objectives of the Code, which are:

to ensure the highest standards of integrity and professionalism in the service of clients, to prevent criminal or regulatory abuse, and to maintain and enhance the reputation of the Island;

to act at all times with honesty and integrity and to apply the "four eyes" principle,

to know the settlors and undertake the necessary due diligence;

to investigate the provenance of the assets proposed for the Trust and to ensure that they are not the proceeds of crime;

to ensure that proposed Trust arrangements would be sustainable if publicly

known and are not a device to conceal assets or put them beyond reach of creditors, tax authorities or other injured parties;

not to set up or participate in sham Trusts where the trustees merely carry out the settlor's instructions and have no significant discretion;

to consider with the settlor at the outset whether there should be an independent Custodian of assets, a Protector or (in the case of a Purpose Trust) an Enforcer;

to invest, distribute and otherwise manage the Trust's assets in accordance with the purposes defined in the Trust deed and any letter of wishes from the settlor;

to disclose to beneficiaries and representative objects of a power, unless there are decisive reasons to the contrary:

the fact that they are beneficiaries or objects of a power; the Trust deed and the settlor's letter of wishes; the identity of the Custodian, the Protector and the Enforcer; the annual accounts, audited where appropriate, including fees charged.

to co-operate with the Island authorities if they need information in the pursuit of enquiries into possible criminal behaviour or breach of regulation,

apart from the above disclosures, to keep the client's affairs confidential;

to ensure that the funds of individual Trusts are totally segregated from each other and from the provider's and custodian's own funds;

to manage the investment of individual Trust funds professionally and responsibly;

so far as practicable, **to** exercise professional oversight of any companies owned by the Trust;

to have a client's agreement with the settlor; to charge a reasonable **level** of fees, accordance with FSC guidelines; to prepare annual accounts for all Trusts, including a statement of fees charged,

to send the accounts to settlors, protectors, enforcers, beneficiaries, representative objects and custodians,

to have the accounts independently audited if the assets exceed [£ 250,000].

to keep minutes of meetings, records and **files**;

to deploy sufficient staff with the required skills and training to look after the Trust's affairs and apply the four-eyes principle;

to maintain adequate levels of working capital and Professional Indemnity and Fidelity Insurance and to inform clients about them;

to manage transfers of clients in accordance with the procedures defined by the FSC;

to have an independent annual audit of their compliance with the legislation and the Code;

to co-operate fully with the FSC and in particulars

to pay the annual registration fees, to submit the provider's own annual audited accounts (including a statement of fee rates),

to submit the annual compliance audit, to submit such other information as the FSC may require, and to co-operate in disciplinary and disqualification procedures.

## 13 CONIPANY AND TRUST SERVICES PROVIDERS

### *13.1 Professional services providers in the Islands*

As discussed in earlier Chapters, professional Trust and Company service providers play an even more important and prominent role in the business of the Islands' international finance centres than in the major onshore centres. They are, indeed, the drivers of much of the Islands' business, especially the Trusts and Companies business.

In Jersey and Guernsey, these providers are sometimes referred to collectively as

"fiduciary service providers" or 'fiduciaries'. This reflects the fact that a large part of

their activity consists in management of assets or businesses on a basis of trust for the benefit of others.

In the present absence of any regulatory system, the number and distribution of such providers is not known. But the Jersey authorities estimate that they have about 200 such providers, including 170 Trust or "managed" Trust companies (or groups of companies) and about 30 company formation and administration agencies which do not provide Trust services.

Guernsey . appears to have 130 or more similar providers and the Isle of Man perhaps 400. The figures, however, are not necessarily comparable. Even if they were, the average size of provider may well differ between the Islands.

*The Trust service providers*, known **in** Jersey as Trust companies, mainly act as professional trustees but also provide other Trust-related services, including setting up Trusts and advice to clients.

Many banks, solicitors and accountants supply such services, usually through subsidiary Trust companies. **There are** also independent provider companies and partnerships.

*The company service providers*, sometimes known as company managers administrators or formation agents, perform various functions in relation to companies, including company formation and sales, provision of registered office or accommodation addresses, company administration, and provision of Director services or Directors.

Some of them operate on an international basis, with branches **in** many countries. They are able to arrange company incorporations in other jurisdictions as well as the Islands.

Trust services providers often provide company services as well. As discussed in earlier Chapters, many offshore companies exist primarily as a convenient means of holding property, financial, business or other assets, and many Trusts have significant company structures beneath them.

Although sole practitioners are less common than they were, I understand that perhaps one-quarter of service providers are still either sole practitioners or have only two or three staff in total

### *13.2 Present legislation and regulation*

As discussed in earlier Chapters, the Islands have a substantial volume of Trust and Company legislation and an established corpus of case law.

In addition, Control of Borrowing Orders and company registration procedures in Jersey and Guernsey enable the Island authorities to exercise some oversight over the formation of new Trust and Company service providers. Jersey and Guernsey, in particular, have actively used this power.

That apart, however, there **is** at present no registration, regulation or supervision of such providers.

### *13.3 Island proposals to regulate service providers*

In all the Islands, the authorities have now brought forward plans to introduce such regulation'.

*The Jersey* authorities have announced plans to introduce a Fiduciary and Administration Business Law in 1999. This is intended to provide the basis for a comprehensive regulatory framework for Trust companies, company administrators, company formation agents and custodians.

*The Guernsey* authorities **have** announced plans to pass new Laws in 1999 on (a) provision of Director services and (b) Fiduciary Business.

As discussed in **Chapter 11**, the former is intended **to** provide a regulatory framework for supervision of those providing Director services by way of business, including Directors themselves.

The latter is intended to bring the supervision of Trust companies, company administrators and professional executors within the statutory functions of the Guernsey Financial Services Commission. The providers would be required in all cases, not to be licensed, but to "notify" the FSC. It would however be an offence to carry on such business without notification. The FSC would not have power to investigate client records but would be able to hire others to do so.

*The Isle of Man* authorities have published proposals, including two detailed consultative papers, to introduce legislation early in the 1998/99 session to license and regulate corporate service providers (CSPs).

These proposals are intended to cover all who provide by way of business company formation and selling services, Directors and professional secretaries, and registered offices and/or accommodation addresses. Only registered CSPs would be allowed to incorporate companies in the Isle of Man. Regulation would be reactive. Manx residents setting up companies for their own use and providers setting up less than 5 companies a year would be exempted.

The authorities have also indicated an intention to introduce similar legislation and licensing of Trust service providers but have set no timetable for this.

The Island authorities have all introduced separate legislation and regulation to deal with investment advisers and other investment service providers.

#### *13.4 Case for regulation*

In my opinion, the Island authorities are right to plan this extension of the regulatory boundary. The case for registering and regulating service providers, and putting the bad providers out of business, is very strong. It rests on two main considerations.

First, these providers appear to have been associated with much of the disreputable business that has come to light in the Islands in recent years. In the course of my consultations with forensic accountants and others, and some study of Court cases, it became clear that a small but troublesome minority of such providers have been associated with disreputable schemes for money laundering, fraud, false booking of profits and tax evasion. In some cases they may

inspire such activities. In others, they may only facilitate them either by colluding with master planners in other jurisdictions or by turning a blind eye. The authorities have not always been able, in practice, to put such providers out of business.

Second, and equally important, the most, and perhaps the only, effective way to regulate the large Trust and company sectors in the Islands is through regulation of the service providers.

As discussed in Chapter 12, the UK authorities do not license or regulate Trust and company service providers. I hope, however, that they will consider doing so.

The British Caribbean territories license providers of company management services as well as Trust service providers.

### *13.5 Objectives for licensing and regulation*

The objectives for licensing and regulation should closely reflect the reasons for introducing them. Above all they should reflect the need to find effective yet practical means for regulating the Trust and Company sectors and ensuring that the Islands' customers are well served.

The main **specific** objectives should be:

to **prevent**, deter and combat *abuse of the Islands' Trust and Company facilities by, customers* wishing to launder money or commit other forms of crime"

to prevent, deter and combat *collusion* between providers and clients in such abuse.

to deter providers from turning a *blind eye* to abuse;

to prevent, deter and *combat fraud and other disreputable Activity* by providers *to the detriment of the Islands' customers.*,

to promote high standards of *business conduct and competence*; with these ends in view, to *put the bad providers out of business*, and by all these means, to protect and enhance the *Islands' reputation*.

### *13.6 Legislation and regulatory structures*

As indicated above, the Islands' proposals envisage somewhat different legislative structures, regulatory coverage and frameworks, and timetables.

In my opinion, a convenient structure is likely to be a single piece of overarching legislation, providing for the registration and regulation of all service providers, supported by specific Codes of Conduct for each of the main specific areas of business, notably:

- Trust services
- Company services
- Director services.

The relevant Codes (or separate Codes) could also usefully set out what is expected of those fulfilling specialist roles such as Trust custodians, Trust enforcers, company secretaries, and compliance auditors.

Box 13.1 indicates what the broad provisions of the overarching legislation might be

This is a generalised version of the Trust providers law sketched in Chapter 12

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The Codes of Conduct, similarly, might be along the lines set out in Chapter 11, Box 11. 1, for Directors and in Chapter 12, Box 12.2, for Trustees and Trust service providers.

The Code of Conduct for corporate service providers might be along the lines of Box 13.2. This is based on the proposals in the Isle of Man's Consultative Paper of November 1997 on The Licensing of Corporate Service Providers, with certain changes discussed below.

There is, of course, no absolute requirement to deploy the legislation and the Codes of Conduct in this way. But such a structure would seem to offer considerable advantages:

*Coherence.* In each area of business, the basic requirements are similar. The FSCs are obliged to register providers, in accordance with 'fit and proper' criteria, and to regulate them in accordance with the relevant Codes of Conduct. The providers are obliged to register themselves with the FSC, to conduct their businesses in accordance with the Codes of Conduct and to submit to regulation.

*Simplicity.* A single overall legislative structure for regulation of service providers would seem to provide an easier and more familiar framework for the many providers who offer two or more different kinds of services than three or four separate laws.

*Flexibility.* With overarching legislation and Codes of Conduct, the authorities would be able to add new Codes or change existing Codes in case of need without primary legislation.

*Speed.* The authorities should also be able, with this structure, to deploy the regulatory regimes more quickly.

Further to the last **point it** would seem very much in the Islands' interests to have the new registration and regulation systems in place by the beginning of 2000.

### 13.7 Main issues

The issues of substance that arise on **these** proposals include the following.

#### (a) *Strategy at introduction*

In any extension of regulatory boundaries, there is always a strategic Issue as to how strict the authorities should be in the initial licensing round. There are two broad options:

**Strictness.** The authorities set high standards from the outset and refuse **to** license questionable operators.



**Leniency.** The authorities **initially** license all, or virtually all, the existing operators ("grandfathering") and hope to weed out later those who fall short.

There are also of course a variety of intermediate options.

In my opinion, the case for strictness from the outset is overwhelming. The main considerations are

First, there is (as discussed earlier) an urgent short-term requirement to put bad or dubious operators out of business so as to prevent them from damaging customers or the Island.

Second, it is far easier not to grant licences at the outset than to revoke licences subsequently.

The leniency option, on the other hand, tempting as it may be in the short term, will not only fail to solve the immediate problems but also store up trouble for later

The authorities must clearly be fair to providers both when introducing the new regulation and subsequently. Decisions which deprive people of their present means of livelihood should not be taken lightly. But the customers and the Islands' reputations must come first. The authorities cannot properly give the benefit of the doubt to providers of questionable fitness and propriety.

As discussed in the previous Chapter, the authorities will be well-advised to give due notice at the outset that the licensing criteria will be tough. Some of the less fit existing providers will then decide not to apply rather than be turned down.

*(b) Requirements to use licensed providers*

If the Trust and Company sectors are to be successfully regulated through the professional service providers, all Trusts and companies in the Islands, except perhaps for companies separately regulated by the FSCs or trading companies formed by residents to serve residents, must be required to have a licensed professional provider.

If Trusts and **companies had** an option to **dispense** with such providers, the regulatory system could **be readily bypassed** and would be ineffective.

*(c) Coverage*

The requirement for licensing or registration should clearly apply to *all* who provide Trust or Company services for customers of the Islands' finance centres. In particular, it should apply with no exemptions to providers:

irrespective of whether they work ' banks, accountancy practices, solicitors, or advocates offices or other partnerships. or as independent practitioners;

irrespective **of** their other professional qualifications (for example as lawyers, accountants, company secretaries or bankers); and

irrespective of the size or scale of the enterprise.

For providers who work in institutions, the institutions or the subsidiary that undertakes the service provider business would be subject to licensing. But it should be open to the FSC to require the institution to identify the staff members concerned and, in case of need, to debar them from taking part in this business.

In [Jersey and] Guernsey, companies may only be formed by Crown Advocates. This requirement has, indeed, provided a valuable sifting mechanism for company incorporations (though not company administrations). The advocates concerned could be registered as corporate service providers under the new regime (unless there were reasons to the contrary in individual cases). It would be for the authorities to decide whether the requirement that only an advocate may apply for incorporation should be retained or dropped.

The requirement for licensing should clearly apply to small as well as large providers. Past experience indicates that some of the most serious problems have occurred with sole practitioners and small partnerships. The four-eyes requirement in the proposed Code of Practice would oblige existing single practitioners to merge if they wish to survive.

Providers who incorporate only a small number of companies each year should likewise be required to apply for licences. Here, too, the risks may be considerable.

*(d) Licensing versus notifying*

The Guernsey authorities' consultative paper on fiduciaries proposes that service providers should not be licensed but should rather be required to "notify" the authorities that they are providers. It would still-be an offence to carry on such business without notification or if the FSC had demurred. But the paper argues that there would be less risk that customers would think that the FSC had underwritten the providers' business. And it might be easier for the FSC to sue them in case of need.

The Isle of Man's consultative paper, on the other hand, proposes a system of licensing and is ready to describe it as such.

In my opinion, the substantive requirement is for a system of licensed and regulated providers. While there is some force in the points made in the Guernsey paper, I doubt that it is helpful to suggest, as the word "notification" does, that the system does not encompass these elements. Other ways can be found to make clear that the FSC does not underwrite the activities of providers and has a clear locus in civil proceedings.

If the term "licensing" is thought to contain too much moral hazard, "registration" would be a possible alternative.

*(e) Beneficial ownership and shadow, Directors*

In my opinion providers should be required to do all they reasonably can to establish the beneficial owner and shadow Directors of companies they incorporate or administer. If they cannot do this, they should not to take on the business at all.

The Caribbean **finance centres** and **the Isle** of Man do **not make** (or propose) this requirement. They allow (or propose to allow) providers to rely instead, if necessary, on the **professional intermediaries who introduced the client**:

The Isle of Man consultative paper suggests that providers should be deemed to have fulfilled their obligations if they have satisfied themselves that the professional intermediary overseas who has introduced a client has a good vetting system and would if necessary allow the provider access to the results.

The British Virgin Islands Code of Practice requires providers only to take reasonable steps to ensure that a professional service client contracting a service on behalf of another client (the beneficial owner or his nominee) has adequate due diligence procedures in place.

In my opinion, it is less than satisfactory to delegate responsibility for due diligence in these ways. The right approach must be that stated at the beginning of this section.

(g) Criminal and civil law

The Isle of Man authorities have proposed that the legislation should create three criminal offences within the new regulatory boundary:

acting as a provider without being properly licensed;

knowingly or recklessly making false or misleading statements or providing false or misleading information to the Regulator; and

obstructing the Regulator during a statutory investigation.

They have also proposed that Regulators should make maximum use of civil law procedures, not least for calling in administrators or liquidators to wind up businesses and for restraint and recovery of assets. As discussed above, the legislation needs to give the authorities a clear locus to use such procedures.

In my opinion, the Isle of Man proposals in **this** respect are entirely right

(h) *Sanctions and Appeals*

Apart from the above powers, the Isle of Man authorities propose, rightly in my view, that the main sanctions should be:

(i) withdrawal of operating licenses.

(ii) fines, at levels to be fixed from **time to time** in subordinate legislation.

The fines need preferably **to** be fixed so **that** providers guilty of disreputable activity stand to lose more than they would have gained had their crimes not been detected.

As all the Island authorities have acknowledged, an Appeals procedure will also be needed.

(i) *Active Enforcement*

The consultative papers of the Isle of Man and Guernsey authorities propose that enforcement of the new regulatory regime should be reactive only, not proactive. The authorities would only respond to complaints or other adverse information. There would be no compliance visits. In Guernsey the authorities do not even plan to take powers to send in their own staff on compliance visits. [I understand that the Jersey authorities have a similar approach in mind.]

In my opinion unenforced regulation, and even reactively enforced regulation, are likely to be honoured in the breach rather than the observance. As many respondents to the Isle of Man's earlier consultative paper argued, therefore, it seems essential to undertake a sensible measure of proactive enforcement, including some on-going inspection of the licensed population. It will be no less important actively to police the "perimeter" of unlicensed business.

I very much hope, therefore, that the authorities in all the Islands will provide for a serious but sensible measure of proactive enforcement. I hope, too, that the FSCs will all have powers to use their own staff as inspectors or investigators as well as outsiders.

(j) Capital adequacy and Professional Indemnity and Fidelity Insurance

If providers fall down for any reason in the services they provide, the client's practical access to redress will depend importantly on the provider's capital base, professional indemnity insurance (to cover mismanagement and incompetence) and fidelity insurance (to cover fraud by staff within the provider's own organisation).

The Isle of Man authorities have proposed **that** providers should be required to certify each year that they **are** able to meet their liabilities as they fall due. This seems to me a promising idea.

in my opinion, the Codes of Conduct should **also** oblige providers:

- to maintain adequate capital resources.,
  - to maintain professional indemnity and **fidelity** insurance that are adequate **in** terms of amounts and coverage; and
- to disclose these matters to their clients in **their** initial client agreements and to inform them subsequently of any major changes.

The broad principles of "adequacy" would best be defined in an Annex to the Code of Conduct.

(k) *Internal controls*

The illustrative Code includes a number of provisions relating to internal management and controls, including the four-eyes principle, rigorous separation of client and provider funds, audited accounts and an annual compliance audit. These are none the less important for being familiar.

(1) *Resources*

Effective regulatory regimes for service providers will be quite resource-intensive. If the authorities opt for a strict initial licensing round, as recommended above, the requirement for staff is likely to be especially great in the early stages of preparing and introducing the new regime.

For these reasons, the Chapter 6 discussion on staff requirements assumed that each of the FSCs would need between four and seven staff in the early stages.

The choice of staff will also be important. As discussed earlier, regulatory regimes on the lines envisaged here are not yet found in the major onshore centres. So there will be no international pool of staff with precisely relevant experience. But it should be possible to build up effective teams including people with experience of company, legal and accountancy regulation, and of compliance and anti-fraud work, as well as some former practitioners.

*13.8 Lawyers and accountants*

In contrast with some other offshore jurisdictions, the Islands all have substantial numbers of resident lawyers and accountants to serve the heavy requirements of their international finance centres. The numbers in the accompanying table are not counted on a consistent basis and may not, therefore, be entirely comparable.

	<i>Lawyers</i>	<i>Accountants</i>
Jersey	270	500
Guernsey	83*	476
Isle of Man	166	444

\*Advocates and English solicitors only. The number of lawyers employed in other businesses is not known.

In the Islands as in other jurisdictions, the members of these professions undertake much of the Trust and Company formation and administration business, often but not always through separate companies. The Islands' finance centres rely heavily on them.

As with other professionals operating in these areas, unscrupulous or incompetent practitioners **can** do great harm by engineering, collaborating in or turning a blind eye to disreputable **schemes** and practices.

The Island authorities have decided that the best way to ensure high standards of integrity and competence among its professional groups is through regulation of particular functions and services, such as Trusts business and Company business, and those who provide them, irrespective of the providers' professional backgrounds.

The many lawyers and accountants who provide such services will therefore be obliged to apply for licenses and submit to regulation, in the ways discussed in this Chapter, 'Just like other providers. There will be no exemptions.

In my opinion this approach is entirely right,

The Islands have also been concerned, again rightly in my opinion, to ensure appropriate professional disciplines for members of the professions.

For lawyers:

The Isle of Man has Law Society and Legal Practitioners Acts of long standing to support its Law Society and Disciplinary Tribunal.

**Jersey too has a Law Society and Disciplinary Tribunal. Legislation is to be brought forward in the forthcoming session to improve the framework for the Law Society and give teeth to the Tribunal.**

In Guernsey, the Royal Court directly regulates the activities of Advocates, with the help of Court rules stipulating how they must handle client accounts. English solicitors are subject to regulation by the Law Society in London.

For accountants, there is no legislation and no local regulation. But all the accountants in the Isle of Man and most of those in Jersey and Guernsey are regulated by the self-regulatory accountancy bodies of England, Wales, Scotland and Northern Ireland.

#### BOX 13.1

#### SKETCH OF OVERARCHING LEGISLATION TO REGISTER AND REGULATE TRUST AND COMPANY SERVICE PROVIDERS

The Financial Services or Supervision Commission (FSC) would be tasked to act as licensors and regulators of Trust and Corporate Service providers and to publish the names and addresses of licensed providers in a public Register.

All persons, partnerships or companies offering trustee or other Trust services or company formation, selling, secretary, administration and Director services by way of a business, and any others defined in an updatable Schedule, would be required to apply to the FSCs for licensing as providers of the services in question.

Only suitably licensed providers would be allowed to form Trusts and companies with special tax status.

In deciding whether to license providers, the FSC would be obliged to satisfy itself that the applicants were **fit** and proper in terms of integrity, solvency, competence, track record and technical support.

The FSC would be obliged to draw up, promulgate and update, after consulting providers, Codes of Conduct for Trust, Company and Director services, and for any other necessary services.

Registered providers of the various services would **be** obliged to comply with the relevant Codes. Some elements in them might be given specific statutory effect.

The FSC would have powers:

- (a) to inspect and obtain information from providers for purposes of enforcement;
- (b) to name, warn, [fine] and / or remove from the Register providers who cease to be **fit** and proper or fail to comply with the relevant Codes of Conduct;
- (c) to approve compliance auditors;
- (d) to bring **civil** proceedings to enforce any aspect of the regulatory system.

The providers would be required to submit to the FSC..

- (a) annual returns, including an audited compliance return and audited accounts-
- (b) ad hoc reports of changes in key personnel and/or legal actions against the provider or its Trusts or companies"
- (c) annual license fees

The providers might also be required to maintain adequate levels of working capital, professional indemnity and fidelity insurance and professional staff, and to keep client funds separate from the providers' own funds.

It would be an offence:

- (a) to act as a provider of the relevant services without registration. or
- (b) knowingly to deceive or mislead customers, or
- (c) knowingly to deceive, mislead or obstruct the Regulator.

## BOX 13.2

### SKETCH OF ILLUSTRATIVE CODE OF CONDUCT FOR CORPORATE SERVICE PROVIDERS

#### BOX 13.2 CORPORATE SERVICE PROVIDERS. ILLUSTRATIVE SKETCH FOR A CODE OF CONDUCT

Corporate Services Providers are required:

- to promote the objectives of the Code, which are:
  - to ensure the highest standards of integrity and professionalism in the service of clients,
  - to prevent criminal or regulatory abuse, and to maintain and enhance the reputation of the Island;

to act at all times with honesty and integrity and apply the "four eyes" principle,

to know their customer, including the identity of any beneficial owners of more than 20 per cent of the worth of the company;

to know and have regular contact with Directors and any "shadow" Directors on whose instructions they act;

to establish the nature of the company's activities, to ensure that they are legal, and to ensure that they are informed of any changes in them;

in the case of asset holding companies, to investigate the provenance of the assets and to ensure that they are not the proceeds of crime;

to ensure that proposed company arrangements would be sustainable if publicly known and are not a device to conceal assets or put them beyond reach of creditors, tax authorities or other injured parties.

to report any **suspicious** to the Island authorities;

to co-operate with the Island authorities if they need information in the pursuit of enquiries into possible criminal behaviour or breach of regulation.

apart from the above disclosures, to keep the client's affairs confidential;

If they are providing Directors for a Company, to ensure that the Directors are fit and proper persons who can be relied on to act in accordance with the Code of Conduct for Directors;

**to** ensure that the funds of individual **asset** holding companies are totally segregated from each other and from the provider's and custodian's own funds;

to have a written client's agreement **with** the Directors, the shadow Directors and the beneficial owners (if different);

to charge a reasonable level of fees, in accordance with FSC guidelines"

to ensure that annual accounts are prepared and submitted for all their companies.

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including a statement of provider fees charged,

to ensure that the accounts are independently audited if the assets exceed [£100,000];

to keep records, files, minutes of meetings and details of post received by the company;

to deploy sufficient staff with the required references, skills, experience and training to look after the Company's affairs;

to apply proper internal controls including the four-eyes principle;



to maintain adequate levels of working capital and Professional Indemnity and Fidelity Insurance and to let clients know what they are;  
to avoid conflicts of interest;

to manage transfers of clients in accordance with procedures defined by the FSC,

to avoid publicity or other material which would bring the Island into disrepute; to record, investigate and as appropriate **act** on complaints;

to have an independent annual audit of their compliance with the legislation and the Code,

to co-operate fully with the FSC and in particular:

- (a) to pay the annual registration fees,
- (b) to ensure that their companies are properly registered and make the proper returns to the Companies registry,
- (c) to submit the provider's own annual audited accounts,
- (d) to submit the annual compliance audit,
- (e) to submit such other information as the FSC may require, and
- (f) to co-operate in disciplinary and licence revocation procedures.

## 14 FINANCIAL CRIME AND MONEY LAUNDERING, POLICY, LEGISLATION AND ACHIEVEMENTS

### *14.1 The Islands' policies*

The authorities in all the Islands have made clear their firm commitment to prevent, deter, detect, pursue and punish crime of all kinds, wherever committed, including money laundering and tax evasion as well as drug trafficking, terrorism and fraud. They are likewise committed to the fullest co-operation with other Jurisdictions to that end.

Effective policies for countering financial crime are clearly essential in any international finance centre of repute. The Island authorities' commitments in these areas are therefore of the highest importance.

### *14.2 Compliance with FATF and other international standards*

In pursuit of these commitments, all the Islands have a policy to comply with the Forty Recommendations on combating money laundering of the international Financial Action Task Force (FATF), revised in 1996. FATF members include Government and law enforcement representatives from all the countries with major financial centres in Europe, North America and Asia.

Expert groups of officials from the UK and Holland found in 1994 that the Islands were well on the way to compliance with the Forty Recommendations. Since then, further progress has been made. New mutual evaluation groups, including experts from FATF countries, are due shortly to assess whether full compliance has been achieved.

Through the United Kingdom, [all the Islands] are parties to the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime. Jersey and the Isle of Man are both parties to the 1988 Vienna Convention against Illicit Trafficking in Narcotics. Guernsey expects to be a party by around the end of 1998.

### *14.3 Types of crime*

The problems the Islands face in the field of financial crime and money laundering are similar to those in other finance centres, both offshore and onshore, but none the less challenging for that:

From time to time, the Islands' customers abuse the Islands' facilities to facilitate international financial crimes such as drug trafficking, terrorism, fraud, theft, insider trading, illegal flight capital, corruption and tax fraud and evasion. All such crimes may be organised either by criminal groups ("organised crime") or companies or individuals.

From time to **time**, customers use the Islands' financial institutions, companies and trusts to hide the proceeds of these and other kinds of crime and make them appear respectable. Such customers, who may again be individuals or companies or organised crime units, typically move money from one centre to another in long trails designed to confound investigators. This is the process now known as money-laundering"

From **time** to time, **financial** and other practitioners on the Islands themselves defraud or otherwise **let** down the Islands' customers.

Whether the Islands have more than their fair share of money laundering and other financial crimes is hard to judge.

There are some who say that the incidence of laundered money in the Islands is unusually high. Compared with the main onshore jurisdictions this may well be so. The Island authorities certainly receive many more requests from other jurisdictions for assistance in the pursuit of money laundering and other crimes than they make themselves. But offshore centres generally probably receive a disproportionate amount of internationally laundered money as the money launderers move the proceeds of crime through a number of different jurisdictions.

The impression of an unusually high incidence of laundering in the Islands may therefore reflect this wider offshore problem. It may also reflect the Islands' successes in detecting, or helping to detect, the activities of international money launderers and the disproportionate publicity that crime with an offshore dimension tends to receive in the world's press.

**There** are others who say that the Islands' business depends importantly on tax fraud and evasion and illegal flight capital.

With regard to tax fraud and evasion, the limited exchanges of information between the world's tax authorities makes any assessment of amounts more than usually hazardous. Many practitioners on the Islands told me that they were unaware of any such problems. The forensic accountants whom I have consulted, on the other hand, clearly felt that the Islands still have a substantial volume of such business.

Schemes used in the Islands, as elsewhere, for evasion of corporate taxes in other jurisdictions include booking of inflated profits to companies in the Islands, sometimes supported by sales of fictitious or overpriced services by such companies to a connected company in the other jurisdictions. Such schemes seem typically to be devised in tandem by professionals in the two jurisdictions.

Schemes for evasion of personal income, capital gains or inheritance taxes seem typically to depend more simply on non-reporting by residents of other Jurisdictions of income received or assets held on the Islands.

The amount of illegal flight capital is equally hard to assess. In the Islands as in other international **finance** centres, both offshore and onshore, a proportion of the assets held by non-residents with the Islands' institutions is likely to be either illegal or of questionable legality in the country from which the assets have been transferred. Whether the Islands have proportionally more or less than other centres is impossible to say.

[The BCCI collapse provides some clue as to the possible-scale of tax evasion and flight capital among the customers of one bank in one of the Islands (the Isle of Man). Approximately one-third of potential claims on the liquidator from Island customers did not materialise. The claimants concerned seem to have thought it worth their while to forswear compensation of up to £ 1 5,000 in order to hide their identities. Not all of them were necessarily evading tax or other overseas regulations. But most of them probably were. As the BCCI saga has revealed, however, BCCI is likely to have had a much higher proportion of disreputable business than other financial institutions.] [Comparable figure for non-resident depositors of London branches being sought.]

The presence of illegal business in the Islands, inevitable as it is, has to be kept in perspective. Much of the Islands' business, ' probably the vast majority, is clearly perfectly legal. As discussed in Chapter 2, there are good many reasons why customers may choose to use the Islands' facilities. For many customers, there are perfectly legal tax and other reasons for doing so. The Islands' institutions mostly take pains to vet and select incoming business. As they have pointed out to me, they have the keenest interest in avoiding illegal or questionable business which could involve them in costly litigation or reputational risk.

That said, the Island authorities fully accept that, like other international Finance centres, they cannot afford to be complacent about abuse of their facilities by criminals. They also accept that in their role as hosts of International finance centres they have an absolute obligation to minimise such abuses.

#### *14.4 Development of **legislation***

The Islands have developed considerable arsenals of legislation to counter financial crime of all kinds. **It** is mostly based on, though not identical to, UK legislation.

As in the UK, **financial** institutions and professionals in the Islands continue to have a common law duty of client confidentiality (though there are no banking secrecy laws). But the Courts have long had powers to override this duty in the pursuit of crime and the recent legislation mentioned above has further enhanced the ability of the authorities to do so.

The Islands have long had legislation on fraud. Guernsey and the Isle of Man have theft legislation, too. [The Islands are also able **in** many cases to participate in Mutual Legal Assistance Treaties (NILATs) between the UK and other countries.]

In recent years they have added to their arsenals *money laundering* legislation on UK lines in relation to drug trafficking and terrorism. This enables the authorities:

- (a) *to trace, seize, restrain and confiscate the proceeds* of drug trafficking and terrorism, and
- (b) to institute obligatory systems of *suspicious transactions* by financial institutions, companies and professionals while also protecting them against liability under the common law duty of confidentiality.

By the end of **this** year, the Islands will all have "**all crimes money laundering**" legislation, again on broadly UK lines, giving the authorities powers similar (but not identical) to those at (a) and (b) above in relation to the proceeds of crimes of all kinds, *including fiscal offences*.

Alongside their fraud and money laundering legislation, the Island authorities have either taken or intend to take two more general sets of powers:

- (a) *powers to obtain information needed for investigations* and *Judicial evidence*, through such means as production orders and search and seizure warrants, for use both in their own investigations and prosecutions and to assist those of other countries. and
- (b) international co-operation powers to obtain information, documents and evidence for use by Courts and investigating authorities outside the Islands and to assist in the forfeiture orders of overseas Courts.

The UK model for (a) above is the Police and **Criminal** Evidence Act (PACE) 1984. The UK model for (b) is the Criminal Justice (International Co-operation) Act 1990.

Also relevant to the combating of financial crime **in** the Islands, including money laundering, are the Islands' legislation on financial regulation, companies, trusts, insolvency and bankruptcy, the forthcoming legislation on corporate and trust service providers, and the Double Taxation Agreements with the UK. Good legislation and regulation in these areas can contribute greatly to the prevention and pursuit of crime.

In summary, therefore, the Islands have either completed or will soon complete an arsenal of legislation on financial crime and money laundering similar to that of the UK.

As discussed below, the Isle of Man has *~y* completed it already. Guernsey will do so shortly. Jersey plans to complete it by the end of 1999.

#### 14.5 *Issues arising on existing legislation*

For the most part, the Islands' existing legislation seems to work well. In relation to drugs and terrorist offences, In particular, the authorities in all the Islands have been able to give exemplary assistance to the investigating and prosecuting authorities of other countries.

As discussed in the next Chapter, the hitherto incomplete state of the legislative arsenal has hindered the Islands' ability in recent times to give assistance in other areas. But that problem should largely disappear when Jersey enacts the two outstanding laws mentioned above. The Jersey authorities, rightly in my view, [are now attaching high priority to this and have set a firm objective to have the legislation take effect by the autumn of next year].

Within the existing legislation and the legislation shortly due to enter force, there are a few problem areas, actual or potential, which merit further consideration. These relate partly to the legislation itself and partly to the policies of the Island authorities in implementing it.

(a) *Restriction of co-operation under all crimes money laundering legislation to locally indictable offences or offences carrying a maximum sentence of not less than one year*

The new all crimes money laundering legislation in Guernsey and the Isle of Man follows the UK legislation in limiting co-operation with overseas authorities over searches and seizures and restraint or confiscation of assets to cases where the predicate crimes would be indictable if committed in the home jurisdiction.

In Jersey, where there is no distinction between indictable and summary offences, the proposal is to limit co-operation to offences carrying a maximum sentence of not less than one year.

In my opinion, limiting co-operation to the proceeds of locally indictable offences (or offences with a defined maximum sentence) is a mistake. The message it gives to the criminal is that offences treated locally as summary offences (or offences beneath the sentence threshold) can be committed with impunity. It is likely to exclude co-operation on most **fiscal** offences (which tend to be summary offences) and all offences concerning specific taxes, such as inheritance and capital gains taxes, that do not exist in the offshore centres. The experience of other offshore Jurisdictions suggests that such limitations may become serious loopholes.

For all these reasons, it is much better in my opinion **not** to limit predicate offences in this way.

The only potential justification for such limitations is pressure on resources. The UK authorities probably feared that, without some limitation, they would be inundated with requests for assistance **which** they would not have the resources to handle. The Islands have followed the UK's lead. But the reality is that no overseas Jurisdictions are so well-resourced that they will pursue insignificant cases

If the UK takes the opportunity to change its legislation in this way, therefore, or to add to the schedule of non-indictable offences where co-operation can be given, I hope that the Islands would follow suit.

In the meantime, the problem in Guernsey and the Isle of Man is less serious in practice than might appear. In Guernsey, virtually all offences are indictable. In the Isle of Man, there is a power (which should, I believe, be used) to add summary offences to the list of offences where co-operation may be given.

In Jersey, the limitation on qualifying crimes would best be dropped altogether. Failing that, the scope of the provisions could be limited to "serious" offences, liberally interpreted.

(b) Crime definition thresholds

A similar problem arises on the Jersey fraud legislation. This legislation applies only to cases of "serious or complex" fraud. **The** Jersey authorities have hitherto interpreted this as meaning frauds, actual or suspected, involving amounts of £2 million or more. They adopted this figure on "the basis of the £2 million figure initially set by the Serious Fraud Office (SFO) in the UK for the rather different purpose of distinguishing cases which the SFO would consider taking over from local Fraud Squads.

The practical effect has been that, in cases of suspected fraud, the Jersey authorities have limited their co-operation with the authorities of the UK and other countries to cases involving amounts above £2 million, while sometimes being prepared to assist in smaller cases considered serious or complex. They have not been prepared to assist in relation to smaller frauds or other crimes.

In my opinion, limiting the pursuit of crime to defined categories of case involving sums of money above a defined level such as £2 million (which incidentally excludes most fiscal offences) risks giving quite the wrong messages to would-be criminals. It leaves an impression that frauds of less than this amount will not be investigated. As discussed above, the only justification for such limitations would be pressures on resources. But overseas Jurisdictions are not in practice so well-resourced that they will pursue insignificant cases.

[EITHER: For reasons such as these, the Jersey authorities are proposing to scrap the quantitative threshold altogether and to set instead a firm presumption in favour of assisting overseas authorities in the investigation of any frauds which the latter authorities consider to be serious or complex.

I am sure . they will be right to do so. Such a course would be consistent with the general policy set out at the beginning of this Chapter.

The authorities would need of course to reserve the right, in this as in other areas, to withhold assistance in particular cases on wider public policy grounds.]

[OR. The Jersey authorities have indicated a willingness to apply the fraud investigation powers more flexibly and to introduce a Police and Criminal Evidence (PACE) Law in 1999.

Welcome as these improvements will be, I very much hope that the authorities will be willing to take the further step of publicly scrapping the quantitative threshold altogether. It would be much better, in my opinion, to set a firm presumption in favour of assisting overseas authorities in the investigation of *any* frauds which the latter authorities consider to be serious or complex. Such a course would be consistent with the general policy set out at the beginning of this Chapter.

**The** Island authorities would need of course to reserve the right, in this as in other areas, to withhold assistance in particular cases on wider public policy grounds.]

(c) Fiscal investigations.

The Jersey [not Guernsey or IoM, I think?] authorities have also had a policy not to assist *investigations* by overseas authorities in purely fiscal cases, though the fraud powers mentioned above would in principle provide the necessary powers to assist on a similar basis as for other kinds of fraud. The Royal Court *is* willing, on the other hand, to meet applications to assist in the provision of *evidence* in fiscal cases where criminal proceedings have begun.

The Jersey authorities have now said that they will be prepared in future to use the powers they have under their fraud law to investigate fiscal crimes which can be regarded as serious or complex fraud.

For the period immediately ahead this seems to me a constructive proposal, especially if the practical interpretation of serious and complex fraud is changed in the way suggested in the previous section. The Police and Criminal Evidence (PACE) and International Cooperation Laws, both proposed for enactment in 1999, will provide a fuller and more permanent solution. The sooner these laws can be enacted, clearly, the better.

*(d) Restraints on sharing suspicion reports outside the Island*

The new all crimes moneylaundering legislation in [the Isle of Man and Jersey] [OR all the Islands] permits the police to disclose information obtained through the suspicious transaction reporting system to people outside the Island only with the Attorney General's consent.

In principle this requirement could result in damaging delays in the transmission of information and troublesome increases in the workloads of the Attorney Generals. However, the Attorney Generals propose in both [all] cases to issue general consents which will permit the police to pass information to defined recipients without specific individual consents.

*(e) Time-bars for prosecution*

*(f)*

As highlighted by the recent Bank Cantrade trial, Jersey has a Miscellaneous Provisions Law, 1978, which requires that the prosecution of any statutory offence must be brought within 3 years of the date when the alleged offence was committed. This time-bar meant that there was no option to prosecute one of the bank staff involved in the Bank Cantrade affair (although that is not to say that prosecutions would necessarily have been brought otherwise).

**The** Jersey authorities are recommending to their Parliament, rightly in my view, that all such time-bars to prosecution should be repealed.

[Do Guernsey or the IoM have anything similar?]

*14.6 Delays and lacunas in existing legislation*

The Islands have generally followed UK models of criminal as well as commercial legislation, sometimes with a considerable time-lag.

In my opinion, following UK models is a sensible approach. The Islands do not **have** skilled resources for law preparation and drafting on a scale which would enable them to re-invent every wheel.

The principal elements in the UK's legislative arsenal for combating financial crime and money laundering are the Acts of Parliament relating to

fraud,  
 theft,  
 extradition  
 proceeds of drug-trafficking and terrorist crimes  
 all crimes money laundering  
 police and criminal evidence and  
 international co-operation.

Also relevant are the Mutual Legal Assistance Treaties with most of the other larger countries.

All the Islands now either have all these elements in place or are well on the way to having them. There have, however, as also in the British overseas Territories, been delays of several years **in** some cases before they have followed the UK's models. These would preferably have been avoided.

Especially in Jersey, moreover, the missing elements in the present legislative arsenal are still the authorities there from co-operating with other jurisdictions to the fullest extent in the pursuit of crime. It is clearly important, therefore, that there should be no further slippage in the timetables for enacting these elements.

The present position in each of the Islands, compared with the UK models, is as follows.

(a) *Isle of Man*

The Isle of Man now has all the main elements in place, including *All Crimes Money Laundering, Police and Criminal Evidence (PACE.) and International Co-operation Acts*. The only small omissions, compared with the UK legislation, are certain additional provisions made in the UK's Proceeds of Crime Act 1995, notably a provision enabling the Court to assume, when ordering confiscation of the assets of a defendant with two or more convictions in the previous 6 years, that the assets are proceeds of crime. The Isle of Man authorities are planning shortly to bring in a similar provision. (Will J & G have this provision?) [Do we need to add the outstanding money laundering provision mentioned in the IoM (Chapter, p 109?)]

(b) *Guernsey*

Guernsey does not have precise equivalents to the *PACE and International Co-operation Laws* in the UK arsenal. [ ? But the authorities are able under other legislation [please specify] to obtain information and evidence and to respond to requests from overseas authorities.

Guernsey's *All Crimes Money Laundering* law is due to be enacted in the autumn. The authorities [already have in place an all crimes suspicious transaction reporting system but] will not have comprehensive powers to search, seize, restrain and confiscate until the new law is in force.

(c) *Jersey,*



Jersey has not hitherto had *PACE or International Co-operation* Laws. In the absence of these, the Jersey authorities do not have powers to obtain information and evidence, or to assist overseas authorities, except in cases related to drugs, terrorism and serious or complex frauds. The authorities intend, however, to have these laws in place by the autumn of 1999.

Jersey's *All Crimes Money Laundering* is due to be enacted in the autumn. As in Guernsey, the authorities' **powers** to search, seize, restrain and confiscate will be **limited** until **the** Law is in force. Their suspicious transaction reporting system, too, will be limited in the meantime to the proceeds of suspected offences related to drugs and terrorism.

[A further lacuna in the Jersey legislation is the absence of *77ieft* legislation on the lines of that in the UK and the other Islands. The law enforcement authorities have found that this further restricts their **ability** to pursue financial crime (please explain in what ways). Can we include some explanation for **the** absence of a Theft Law is there any intention to introduce one? If so, when?]

#### 14.7 Improving the legislative arsenals

There are several areas, both in the UK and in the Islands, where the present legislation and international agreements might be improved so as to strengthen **the** hands of the authorities in the pursuit of financial crime and money laundering,

##### (a) A general law on co-operation

As the above discussion has indicated, **the** legislation enabling the UK and Island authorities to counter **financial** crime and money laundering and to assist overseas authorities has grown incrementally over **the** past 15 years.

**The** result is that the authorities in each Jurisdiction have differing powers, circumscribed in a variety of different ways, in relation to differing kinds of offence, including some choices as to which piece of legislation they rely on in particular cases. **The** regimes differ as between drugs, terrorism, fraud, corruption, tax and money laundering cases **in** ways that have no obvious rationale.

There is no **simple answer to the** simple question: "How far are you able to co-operate with overseas authorities in **the** pursuit of crime?"

For law enforcement and other professional practitioners, the variety of powers is unhelpful. There may therefore be a case for considering a single, general law on co-operation, along the lines sketched in the accompanying Box, to replace the existing proliferation of tightly drawn provisions.

Such a law might empower the authorities of the home Jurisdiction to investigate, obtain evidence and restrain assets at their discretion, both on their own account and in response to requests from the authorities in other Jurisdictions, in relation to all criminal and civil cases.

As in much existing legislation on regulatory co-operation, the powers might be available irrespective of whether the crimes or regulatory breaches would also be crimes or breaches in the home **jurisdiction**.

#### BOX 14.1

### GENERAL LAW ON INTERNATIONAL CO-OPERATION AN ILLUSTRATIVE SKETCH

The authorities would, however, retain the right to decline requests from overseas authorities where there were good reasons. The requesting authorities might, for example, be unable or unwilling to do for **the** home jurisdiction, or for themselves domestically, what they are asking the home jurisdiction to do. Or there might be wider considerations of public policy or human rights.

If the UK should think it right to adopt a simple general law along these lines, which might offer a useful standard for international practice, I hope that the Islands would be willing to follow **suit**.

It may well be that, for one reason or another, such a law would not be practicable or convenient. If so, however, a reasonable aim would be to amend existing laws over time to produce the same effect.

#### (b) Information gateways

If the authorities inside a Jurisdiction are to be successful in the pursuit of crime, they need to be able to share information with each other. The UK and the Islands have similar "gateways" for this purpose.

In both the UK and **the Islands**, the most important lacuna seems to be the inability of the Tax authorities to supply information to other authorities and, to the extent permitted, vice versa. Such information is potentially invaluable in the pursuit of crime. Only criminals **benefit** from the absence of such a gateway.

If the UK is able to introduce such a gateway, therefore, I hope that the Islands will be willing to follow suit. It would of course continue to be necessary to pass on information received from overseas authorities only to the extent that the latter authorities were content for this to happen.

There may likewise be scope for improved gateways between regulatory bodies and public authorities. In this case, the EU Banking Directives limit the use that can be made of information exchanged between Jurisdictions.

#### (c) *Resolving Jurisdictional disputes*

With the increasing internationalisation of criminal activity, and the increasing tendency to launder the proceeds of crime by transfers between different jurisdictions, the problem of which country has Jurisdiction in particular cases has become increasingly frequent.

If a company suspected of criminal activity or money laundering turns out to be registered in the Caribbean, with UK and American principals, a Swiss company agent and administrator, a headquarters **office** in the Channel Islands and a bank account in the Isle of Man, which of the **finance** centres concerned should take the lead in prosecuting? The danger is that none of them will. In that case, the criminal will be encouraged to develop further criminal activities along similar lines. -

The problem may have further dimensions as well. The criminal activity may involve civil regulatory as well as criminal offences. The Jurisdictions concerned may have different kinds of law and investigation systems.

Neither the Islands nor the UK can solve these problems on their own. The solution must lie in an international agreement, perhaps under the aegis of the FATF, for the rules of engagement. Such an agreement might put the onus on the country of residence of the principal defendant to Prosecute if other jurisdictions are unwilling to do so.

(d) *Double Taxation Agreements (DTAs)*

With the removal of exchange controls and continuing improvements in the technology for money transmission, the evasion of taxes through false booking of profits, bogus international transactions and non-reporting appears to be a problem of major proportions for virtually all jurisdictions. As the EU member states have recognised in the EC Mutual Assistance Directive of 1977, the exchange of information between tax authorities is one important means for combating such evasion.

Each of the Islands had a Double Taxation Agreement with the UK which includes provisions for exchanging information. These agreements have a number of drawbacks, including a provision whereby information exchanged under the Agreements may not be used in evidence.

It seems clear that the present DTAS, which date from the [ 1 950s], should now be replaced by *either*

- (a) modern DTAS, based on the OECD model, *or*
- (b) modern Exchange of Information Agreements (EIAs), based on the 1977 EC Mutual Assistance Directive.

Either way, the information exchanged should cover on request, spontaneous, automatic and personal information, as defined in the EC Directive. The coverage should preferably be as comprehensive as possible. The authorities should be prepared, moreover, to give assistance even in cases where they themselves have no Interest in the tax obligation.

14.8 *Achievements*

In the combating of **financial** as well as other crime, prevention and deterrence are clearly of the highest importance. And these in turn depend not just on detecting and convicting

criminals and removing their ability to operate (for example through prison sentences or de-licensing) but also on depriving them of their gains and taking the profits out of crime. As one offender famously said..

"I'm not bothered **how** long they give me so long as they don't take away all my, [expletive deleted] money"

In terms of taking the profits out of crime, the UK has not so far been very successful. Amounts recovered are barely significant in relation to the scale of the problem or recoveries made by the US authorities.

The experts seem agreed that the sums of money laundered through London alone each year amount to many billions of pounds, probably more than £100 billion. In no recent year, however, have tile confiscation orders issued under the UK's Drug Trafficking legislation amounted to more than £30 million. The amounts actually recovered, moreover, have typically been around one-third of these sums, with variations from year to year. Recoveries under the other recent legislation **have** (barely yet begun].

The Islands, for their part, have all had considerable successes in individual drug trafficking cases. The US Agencies have commanded them for assistance given. In relation to the likely scale of the problem, however, the Islands too, with their similar legislative frameworks and practices, may not be doing much more than scratching the surface.

In the field of tax evasion, the position looks similarly problematic. A recent calculation suggests that tax evasion and avoidance in the UK could be running at an annual rate of at least £25 billion, compared with special compliance recoveries of around £ 2.5 billion (Martyn Bridges, Journal of Financial Crime, Vol. 4, No2). In many cases, evasion techniques involve the use of offshore centres. That is wily, as discussed above, good cooperation between tax authorities, including offshore tax authorities, is so important.

With regard to insider dealing offences, again, **soaring** trial costs have typically dwarfed the amounts recovered-

Disappointing as the record to date has been, it would in my opinion be wrong to conclude that the present legislation, intelligence and enforcement apparatus is wrongly conceived or incapable of delivering results. It must be exercising a major deterrent effect. Without it, the amount of financial crime and money laundering would doubtless be significantly greater. Many criminals in other fields are identified through financial intelligence. The system is, moreover, fairly new. Even in the UK, the full effects will not be felt for another year or two.

That said, the battle against financial crime, including money laundering and tax offences, is not yet being convincingly won anywhere. It will therefore be an important task for the authorities in the UK and the Islands, as in other countries, to consider what more can be done, in terms of legislation, systems and practices.

#### *14.9 Possible measures to take the profits out of crime*

With regard to legislation and the law, there are three areas, all potentially important, which could have a significant impact in taking the profits out of crime and disrupting the schemes of criminals. In the first two of these, it would be for the UK to take the lead and the Islands to

follow. In the third, the Islands are already taking the lead and the UK might be well-advised to follow.

*(a) Unexplained life-styles*

In the United States, the authorities have powers to restrain the assets of people with unexplained life-styles until they have accounted for them. These powers have proved a highly effective means of recovering or confiscating the proceeds of crime, especially tax evasion, and may explain the much higher rate of recoveries than in the UK.

In Ireland, too, the Courts now have power to restrain the assets of persons suspected of criminal activities until they have proved their innocence. Significant numbers of criminals are believed to have moved elsewhere as a result.

Further afield, Governments in South East Asia apply a similar reversal of the normal burden of proof where public servants have means and life-styles beyond their incomes.

In the UK and the Islands, the authorities do not at present have similar powers. The closest (but not very close) approximation is the provision in the Proceeds of Crime Act 1995 whereby the Courts may now assume, when ordering confiscation of the assets of a defendant with two or more convictions in the previous 6 years, that the assets are proceeds of crime.

If the UK authorities do decide to take powers to restrain assets, and reverse the burden of proof, in cases where people are seen to live beyond their visible means, I hope that the Island authorities will be willing to follow suit.

*(b) Use of civil laws and locus*

In the UK, as in most other Jurisdictions, the authorities have not in practice succeeded in bringing criminal convictions for financial crime, such as fraud, corruption, insider dealing, money laundering and tax evasion, on a scale remotely proportionate to the scale of crimes committed. Even where criminals are convicted, moreover, the authorities have not so far been very successful in depriving them of the proceeds of their crimes.

As part of their response to the problem, the authorities make some use of civil as well as criminal law procedures when trying to recover proceeds of crime. The Tax authorities, for example, make frequent use of Mareva injunctions to pre-empt disposal of assets ahead of confiscations and recoveries. The Island authorities employ similar techniques.

There is, however, a school of thought which argues that, as in the United States, the tax and other prosecuting authorities should make much more extensive use of civil powers (see Barry Rider (ed.), *Laundering Control*, Roundhall, Sweet and Maxwell, 1996, pp 26-27). Burdens of proof are typically lower in civil cases, the laws of evidence more relaxed, and the procedures faster, not least for international co-operation. Civil forfeiture powers, moreover, can in principle be used in cases where defendants cannot be brought to Court (for example, because they are dead).

Regulatory authorities have successfully used such powers (?not least in the Isle of Man). Tax authorities, too, have used them to a limited extent.

The authorities may sometimes have difficulty in establishing *locus standi* when using civil procedures for such purposes against criminal enterprises. In general only the victim *has* locus to sue. But these problems might be eased through new statutory provisions allowing the authorities concerned to bring civil law proceedings to freeze assets of those under suspicion and remove them from convicted offenders.

In both the UK and the Islands, the authorities may wish to consider these points.

Whether or not the authorities decide to extend the use of civil procedures in this way, and to make statutory provision as required for *focus*, the autonomous development of the civil law itself may powerfully reinforce the criminal provisions of the latest legislation in deterring financial crime and money laundering.

Recent civil law cases in the UK and the Isle of Man have increased the risks to professional service providers and advisers if they turn a blind eye and do nothing when they suspect wrongdoing (Barry Rider, *ibid*). It has now been fairly clearly established that professionals who have grounds for suspicion:

- (i) are potentially liable if they turn a blind eye instead of investigating something which clearly should have been investigated (AGIP (Africa) Ltd v Jackson, 1991); and
- (ii) have a duty to identify and warn potential victims of wrongdoing (Finers (a firm) v Miro, 1991).

Liquidators in particular would probably wish to bring suits for restitutions against professionals who have turned a blind eye or remained inactive in such circumstances.

In the light of these judgements, the potential civil liabilities of professional advisers and service providers who turn a blind eye to clear cases of money laundering or other financial crimes must be on a scale to dwarf the penalties under the new criminal legislation for failure to report suspicions. The requirement in the criminal legislation to report suspicions, moreover, makes it less likely in practice that oversight would be a convincing defence.

(c) *Licensing and disqualifying the service providers*

Another valuable element in strategies for preventing financial crime is the licensing, regulation and, as necessary, disqualification of the professional service providers, Trust companies, company directors and administrators, agents and advisers who are potentially facilitators of such crime.

As discussed in Chapter I- such providers, if not fit and proper, risk bringing finance centres into disrepute, either by introducing and condoning bad business or by defrauding or otherwise letting down their customers. The ability to put disreputable, dubious or incompetent providers out of business is therefore crucial.

A further reason for bringing all who provide such services within the regulatory boundary is that they are well placed to know about disreputable activities masked by company and Trust vehicles.

From this point of view, too, therefore, the Island authorities seem to me to be right to extend the regulatory boundary, as they propose to do, to include Trust and company service providers.

If this policy is combined with the measures discussed earlier in this Chapter and those discussed in earlier Chapters for effective enforcement of regulation and improved regimes for companies and Trusts, the Islands will, I believe, have an outstandingly good total apparatus for preventing, deterring and combating financial crime and money laundering.

The U.K, for its part, does not regulate Trust or company service providers. Although many of the individual providers are solicitors and accountants who are self-regulated by their own professional bodies, their conduct of Trust and company business as such is not regulated. Service providers who are not solicitors or accountants are mostly unregulated by any public or professional body.

The reason why the UK does not regulate such providers is doubtless that they play a part in the Islands. Their much smaller part in the company and Trust sectors in the UK have not, therefore, been perceived as a major problem.

On the other hand, the reasons for extending the regulatory boundary in the Islands, both regulatory and counter-crime, apply with similar force in the UK, even if the population of providers is proportionately smaller. When the Islands extend the boundary, moreover, the less reputable providers will be tempted to transfer their activities to the mainland.

I hope, therefore, that the UK authorities will consider extending the regulatory boundary in the same way as the Islands propose to do, while also improving the disclosure regimes for companies and the regulation of Trusts. These matters would naturally be considered as part of the forthcoming Review of company legislation and the introduction of the Financial Services Authority.

#### *14.10 Tax avoidance and "harmful tax competition"*

This Chapter and the two succeeding Chapters make frequent references to tax fraud and evasion as being a significant element in the portfolio of criminal behaviour with which all finance centres have to contend.

There is a separate and very important set of issues, mentioned in Chapters 2 and 10, concerning (legal) tax avoidance by the Islands' customers. The G7, the OECD and the EU have all been discussing the issue of "harmful tax competition" by offshore finance centres generally through low levels of tax, the absence of certain taxes and special corporate tax vehicles.

The Island authorities have argued with force that the issues involved in harmful tax competition are far from simple or straightforward. They have made known, rightly in my view, that they wish to play a full and constructive part, through whatever channels are available, in the on-going international discussions.

Although there are **plenty** of artificial tax schemes and structures where the distinction

between (legal) tax avoidance and (illegal) tax evasion becomes blurred, the basic distinction remains valid. The present report does not need, therefore, to discuss the issues of legal avoidance or harmful competition, which anyway lie outside its terms of reference

## **15 FINANCIAL CRIME AND MONEY LAUNDERING PRACTICALITIES**

### *15.1 Overview*

This Chapter considers how the Islands' systems work in practice to combat financial crime of all kinds, including money laundering and tax evasion. It looks first at areas of special interest to overseas authorities pursuing crimes:

intelligence  
 investigation  
 obtaining evidence  
 tracing, restraint and confiscation of assets  
 extradition,

and then at domestic prosecutions, convictions and penalties.

The overseas authorities whom I consulted were agreed that the Island authorities have been notably successful, as well as immensely helpful, in the pursuit of drug trafficking and customs and excise offences, and not only in these areas. Where problems have arisen, they have mainly been in other areas.

### *15.2 Intelligence; suspicion reporting systems*

The Island authorities recognise that good intelligence is all important in the pursuit of crime, as is the exchange of intelligence with overseas authorities. Anti-money laundering policies, in particular, depend on this.

In keeping with best international practice, therefore, as set out in the FATF's Forty Recommendations, the Island authorities have introduced systems of suspicion reporting by the financial, professional and company sectors. The systems are modelled on the UK's system.

#### *(a) Duty of confidentiality*

As discussed in Chapter 14, information on customer finances held by the financial and professional sectors in the Islands continues, as in the UK, to be protected by a common law duty of confidentiality. The Courts have long been able to override this duty for the purposes of criminal investigations or proceedings. The new legislation defines further circumstances where the duty is overridden.

The drug trafficking and counter-terrorist legislation obliges financial institutions, companies and professionals, as in the UK, to report to the authorities transactions which they suspect might be related to these forms of activity. It also protects the staff concerned from being sued for breach of confidence.



The new all-crimes money laundering legislation (or related legislation) will shortly extend the reporting obligation and the protection for staff, as in the UK, to transactions which institutions and staff suspect might be associated with crimes of *all* kinds, including tax evasion. It will shortly be an offence for staff not to report such transactions to the authorities where there are clear grounds for suspicion. [It won't be a criminal offence in any of the Islands to report when there is no suspicion, will it?]

The Island authorities to whom these suspicion reports must be made are the joint Police/ Customs Financial Investigation Units in Jersey and Guernsey and the Police's Fraud Squad in the Isle of Man. They in turn are obliged to treat these reports in confidence.

*(b) Obligations of reporting organisations*

In all the Islands, the authorities have gone to considerable lengths, in co-operation with the Financial Services Commissions and bodies representing the industries, to ensure that reporting organisations and individuals understand their obligations and their duty of vigilance under the new legislation for reporting of suspicions. They are required:

- to have suitable internal compliance systems and procedures;
- to determine the, identity of customers or potential customers,
- to recognise suspicious transactions or activities and report them to the authorities;
- to keep records for prescribed periods;
- to identify and train reporting officers and key staff, to keep in touch with the authorities and the FSCS;
- to arrange for regular monitoring of their arrangements by internal auditors and compliance units.

*(c) Coverage of crimes: tax evasion*

The new legislation governing the suspicion reporting system, like that of the UK, covers the proceeds of all locally indictable crimes (or, in the case of Jersey, all crimes with a maximum sentence of one year or more). Chapter 14 discussed the disadvantages of these formulations.

As in the UK, locally indictable crimes include locally indictable crimes of tax evasion. Finance sector staff are obliged, therefore, to report suspicions of tax evasion. In the United States, too, reporting bodies are obliged (under separate legislation) to report suspicions of tax evasion as well as other crimes. In most of the European countries, on the other hand, Governments have bowed to pressure from the banks. They and other reporting bodies are not, as yet, obliged to report suspicions of tax evasion.

In my opinion, the Islands are right to include tax evasion and other tax offences within the transaction reporting system, as in the UK and the US. Not only is there no significant moral distinction between defrauding the tax authorities and defrauding anyone else. But excluding tax evasion from the predicate offences covered by the suspicious transaction reporting system gives the perfect alibi to institutions or staff disinclined to report suspicions. They can excuse failures to report by saying that they assumed the offences to be tax evasion.

Reporting institutions and staff are not, of course, obliged to be expert in criminal or tax laws throughout the world. Neither is it for them to judge whether suspicions concerning non-

residents should be reported to the authorities of the countries concerned. Their obligation is simply to report suspicions to the Island authorities.

(c) *Institutional coverage, including companies professionals and bureaux de change*

In the Islands, as in the UK, the obligation to make suspicion reports extends to all categories of financial institution, trust companies, other companies, lawyers, accountants, investment advisers and other partnerships and individuals. There is a limited exemption for information covered by legal privilege.

In my opinion, this comprehensive coverage must be right. In many countries, however, including the US and France, lawyers and accountants are not yet obliged to report.

Among the bodies covered by the new reporting obligations are the *Islands' bureaux de change*. Like other bodies, these bureaux are required to have appropriate compliance systems as well as making reports.

The Islands have many fewer such bureaux than (say) Gibraltar. As in the U.K, they are not subject to regulation by the Islands' FSCs because they are simply traders in currencies and do not take deposits, conduct investment business for clients or undertake any other forms of fiduciary responsibility.

(e) *Levels of reporting*

In all the Islands, even ahead of introduction of the All Crimes Money Laundering legislation, the level of suspicion reporting has been impressive. The new system has led to a step-jump in the quantity and quality of intelligence.

As indicated in the accompanying table, the Island authorities received 1670 suspicion reports In 1997. This figure compares with only some 13,000 in the UK (excluding reports from the Islands).

The vast majority of reports have come from banks, though life insurance companies too have made a large number and trust companies a significant number. Reports by other groups have so far been limited.

The table shows the number of reports made by each group in 1997 in the three Islands taken together.

### **SUSPICIOUS TRANSACTION REPORTS IN THE THREE ISLANDS**

<i>Institution</i>	<i>Number of reports, 1997</i>
Banks	1231
Insurance companies	366
Other <b>financial</b> institutions	7
Trust companies	35
Other companies	3

Lawyers	2
Accountants	9
Investment advisers	2
Other partnerships and individuals	<u>15</u>
TOTAL	<u>1670</u>

As discussed above, the recipient authorities in each Island are responsible, along with the regulatory authorities, for ensuring that all local institutions, companies and partnerships have proper internal systems for reporting suspicions. The figures suggest that groups other than banks and insurance companies may not yet have adequate reporting systems. [The authorities propose, therefore, rightly in my view, to target their education and training programmes on these groups.]

In a significant minority of cases, suspicious transaction reports lead to discoveries of money laundering or other crimes such as banking frauds.

(f) *feedback*

The Island authorities are well aware of the need to provide feedback to the provider institutions. It is clearly important that they should do so.

(g) *Sharing of information*

The Guernsey and Isle of Man authorities feed all their suspicion reports into the NCIS database in London. The Jersey authorities have in the past fed in only a limited number of reports but propose to bring their practice into line with that of the other Islands.

With advancing technology for communications and money transmission and the globalisation of crime, intelligence professionals need to be able to share intelligence quickly and in confidence with counterparts in other countries. As discussed in Chapter 14, the Island authorities mostly have a good record in this and have taken steps to remove unnecessary obstacles

### 15.3 *Intelligence: other aspects*

The suspicion reporting schemes enable the authorities to build up information databases which are invaluable in the pursuit of crime of all kinds, not just financial crime. Other sources, however, are important as well.

One such source is companies data. As discussed in Chapter 10, Jersey and Guernsey collect information on the beneficial ownership of companies registered in the Islands though not of other companies operating on the Islands. Its value would be much increased if the proposals discussed in Chapter 10 were implemented.

Another valuable source is information from members of the public. To facilitate this, [all?] the Islands have public "crimestopper" lines to the police. There may be a case for a specific "financial crimestopper" line to the Islands' Financial Investigation Units or Fraud Squads.

## 15.4 Investigation

When the authorities have intelligence that a crime has or may have been committed but do not have enough information to bring charges, they need to make investigations. This "investigation stage" often requires co-operation by other authorities both inside and outside the jurisdiction.

The Island's police authorities have had some problems at the investigation stage, both when they have needed to make investigations themselves and when foreign authorities have asked them for help.

The Islands receive many more requests for help than they make themselves. This imbalance arises because their international finance centres do business primarily with customers resident elsewhere. The practical issue, therefore, has more often been the Islands' ability to provide assistance to others than the ability of others to provide assistance to them.

### (a) Deficiencies of legislation

As discussed in Chapter 14, the main problem has been that the legislation empowering the Islands' police authorities to make investigations and assist other countries has hitherto been patchy and deficient. This has put the police in a difficult position. They have often not had the powers to give the authorities in other countries the help they would have liked to give.

The Isle of Man authorities have now resolved this problem. [The Guernsey authorities will shortly have done so. The Jersey authorities expect to have done so by the autumn of 1999].

In Jersey, the authorities' policies of not helping in fiscal cases and limiting assistance on fraud to cases above £2 million have been a further problem. [These problems, too, however, are about to be resolved.]

To judge by my discussions with the authorities in several countries, four further problems are worthy of mention.

### (b) . Different kinds of investigating authority

Some of these authorities told me that they have difficulty in co-operating with different kinds of investigating authority in other countries. This problem tends to arise when the task of investigation falls to prosecuting authorities in one country (as generally happens in the European countries) and to the police or Customs in another (as in the UK and the Islands). Co-operation may then be problematic, especially where the enabling legislation does not allow for differences in responsible agencies or procedures in other countries.

The problem seems to arise most often when other European countries need to co-operate with the UK. Similar problems are liable to arise, however, when they need to co-operate with the Islands.

In my opinion, these problems must be for the UK to resolve in the first instance with other larger jurisdictions. The Islands would then be able to adopt similar solutions. The problems cannot be insuperable. There should be no difficulty in resolving them through discussion

leading to Memorandums of Understanding and, if necessary, minor changes in the wording of legislation.

*(c) Routing of requests*

The prosecution, police and regulatory authorities in some of the countries I visited seemed to believe that requests for assistance from the Islands have to be routed through the Home Office in the UK or even the Foreign and Commonwealth Office. This misperception arises at the stage of obtaining evidence as well as at the investigation stage.

In fact there is no such requirement. The right course for overseas authorities is to make contact directly with the relevant Island authorities.

*(d) Assumptions that no assistance will be forthcoming*

Some of the overseas prosecutors and regulators I met, perhaps influenced by responses received in other offshore centres, assumed that there was no point in asking the Islands for assistance in the investigation of crimes or regulatory offences, since no assistance would be forthcoming.

As will be clear from the above discussion, the Island authorities all edgy have a firm policy of full co-operation with other countries in the pursuit of crime. There is *every* point, therefore, in asking the Island authorities for assistance. I hope that the present report, and the prospectuses in the Island Chapters, may help to clarify this.

*(c) Facilities for overseas investigators*

A final point, which the authorities in several countries made to me, is that investigation is greatly facilitated if the requesting country's own investigators are able, in appropriate cases, to join the local investigators in making searches and conducting interviews.

In practice, [?all] the Island authorities are now willing to do this.

### 15.5 *Obtaining evidence*

As discussed above, some of the difficulties associated with the investigation stage have arisen also at the stage of obtaining evidence for use in Court. For the most part, however, the Islands' procedures for obtaining evidence for overseas authorities have been less problematic.

Although the areas where assistance can be given have been limited in the ways already described, the authorities have been able to provide assistance to overseas authorities in the vast majority of cases where formal requests have been made. The Island Chapters set this out more fully.

*(a) Letters of Request procedure*

In (all] the Islands, the traditional procedure for providing evidence is through formal. Letters of Request, known in Jersey and Guernsey as "Commissions Rogatoires". [IoM].

Under Evidence (Proceedings in other jurisdictions) Orders dating from the early 1980s, the Island Courts can comply with Letters of Request from Courts in other jurisdictions where proceedings have begun. They can order the provision of documents or evidence for use in such proceedings. There is no restriction on the type of crime except that political offences are excluded. The Jersey authorities, like the other authorities, are able to give assistance on purely fiscal cases under this statute.

[Is this what happens in the IoM]

The more recent legislation on fraud [? and drug trafficking, terrorist offences, insider dealing and all crimes money laundering?] offers a faster procedure for obtaining and providing evidence. The Law Officers can authorise this without applying to the Court. (Is this true in J and IOM?I. The authorities are always willing to advise overseas jurisdictions on the simplest way of proceeding.

*(b) Swearing of documents*

Some problems have arisen from time to time on the swearing of documents for use as evidence in the Courts of other jurisdictions. The US Courts in particular require sworn statements of authenticity under penalty of perjury before such documents can be used in evidence.

In my assessment, these problems must be soluble. The Evidence (Proceedings in other jurisdictions) Orders already mentioned allow the Courts in Jersey [and Guernsey?] to order that evidence be given under oath for use in other jurisdictions. The question is what happens on the rare occasions when witnesses are reluctant to sign the relevant affidavits. The authorities have told me that the problem can always be solved in case of need through the Letter of Request procedure. [IoM?]

*(c) Evidence in fiscal cases*

With regard to fiscal cases, the Double Taxation Agreements (DTAs) with the UK do not permit information exchanged under the Agreements to be used as evidence. As discussed in Chapter 14, this and other aspects of the DTAs are due for early review by the UK and the Islands.

The Tax authorities in all the Islands have no general powers to collect information for the benefit of tax authorities in other jurisdictions. But the authorities are prepared to obtain evidence relevant to criminal proceedings in the same way as for other categories of offences.

[Do the authorities in any of the Islands need to have an Island "tax interest" before they are able to give assistance at the investigation or evidence or confiscation stages?]

*15.6 Extraditions*

The UK's Extradition Act 1989 applies directly to all three Islands. Extradition proceedings, if needed, take place before a Metropolitan Stipendiary Magistrate in London. The Island Courts do not have power to prevent the removal of a defendant to the UK, though in Jersey warrants issued by magistrates in the UK have to be endorsed by the Bailiff.

### *15.7 Restraints and confiscations*

All the Islands are able and willing to trace, restrain and confiscate assets held by suspects or convicted criminals, whether based on the Islands or overseas, where the predicate offences are concerned with drugs or terrorism. As explained in the Island chapters, the Island authorities have already confiscated significant amounts under the drug trafficking legislation.

The new All Crimes Money Laundering legislation in Jersey and Guernsey will extend similar powers to proceeds from crimes of all kinds, subject to the "locally indictable offences" limitation in Guernsey and the 'maximum sentence of a year or more' limitation in Jersey discussed in Chapter 14. These powers will extend to the proceeds of tax offences.

In the Isle of Man, the authorities already have similar powers in relation to crimes of all kinds under the Criminal Justice Act 1990, though the proceeds in individual cases have (regrettably in my view) to be at least £10,000. The Island's new All Crimes Money Laundering Act makes no changes with regard to powers of confiscation. But the authorities plan early legislation [? to bring the powers into line with those of the UK].

When the new legislation is in place, all three Islands will be able and willing to restrain and confiscate proceeds of crimes of all kinds, including tax evasion, in response to requests from overseas authorities, within the limitations just mentioned.

Whenever necessary, civil forfeiture procedures can be used as well. The Islands' Courts regularly issue Mareva restraint injunctions. They also can and do order financial institutions to disclose information in civil proceedings for the purposes of tracing the proceeds of financial crime. As discussed in Chapter 14, there may be scope for extending the use of civil law remedies.

### *15.8 Prosecutions and convictions*

Where the Islands themselves are the lead-jurisdictions, they all have a policy to prosecute financial crime, like other crime, whenever there is sufficient evidence and a reasonable prospect of conviction.

The Island authorities have all brought some cases relevant to the international finance centres over the years. Such cases have not, however, been common. In the vast majority of cases, criminal offences involving the international finance centres have been committed elsewhere. The Islands' main role has therefore been to assist the investigating and prosecuting authorities of other jurisdictions. as described above, rather than prosecute the cases themselves.

Where the Island authorities have brought prosecutions, conviction rates have generally been high. They rarely give immunity from prosecution.

The case which has attracted most attention in recent years is the Bank Cantrade case in Jersey (1998). The Jersey Island Chapter includes a brief description.

The continuing civil litigation on the case restricts what can be said about it. But the case concerned the misleading selling of a foreign exchange investment scheme, failures to disclose investment losses, and the roles of the dealer who managed the investments, his accountant and the Bank.

The Jersey authorities brought prosecutions, later than they would have wished, against the bank-, two bank staff, the dealer and the accountant. The Bank pleaded guilty to charges of criminal recklessness. Other charges against the bank were dropped. Charges against one of the bank staff were time-barred. Charges against the other were dropped on the grounds that conviction was unlikely. The dealer and accountant were both found guilty and sentenced to and..... years in prison, respectively.

There has been some public criticism of the authorities' handling of the case, especially the delays in bringing charges and the subsequent dropping of some of the more serious charges. The authorities themselves have been anxious to learn from the experience.

On the question of delays, the authorities fully accept that the statutory time-bar on prosecutions is unfortunate. As discussed in Chapter 14, they are proposing that it be repealed. Another lesson they have drawn is the importance of bringing in specialist Counsel and forensic accountants from England at the earliest stage in cases of such size and complexity.

On the question of charges brought and dropped, the critics concerns are understandable. The Jersey authorities were advised, however, by senior English Counsel. They succeeded, moreover, in obtaining two guilty verdicts and a partial guilty plea in a very complicated case. Prosecuting authorities need to be realistic. In most of the world's leading jurisdictions, prosecutors have tended to find great difficulty in obtaining convictions

## 15.9 Penalties

The Royal Court in Jersey has a policy to impose more severe sentences than in England. The Guernsey and Isle of Man Courts follow English sentencing practice.

## **16 FINANCIAL CRIME AND MONEY LAUNDERING: RESOURCES AND PRACTICALITIES**

### *16.1 Policy and resources*

In all the Islands the authorities are firmly committed to providing the necessary resources of judiciary, prosecution, law enforcement and intelligence necessary to police their international finance centres effectively. The importance of this commitment needs no elaboration.

### *16.2 Judiciary and prosecution resources*

As explained in Chapter 5 and the individual Island Chapters, each Island has two senior *Judges* and supporting Judges. Whenever necessary, Judges can be brought in from the UK as well. The Appeal processes involve the UK's legal establishment.

My impression is that, with rare exceptions in earlier times, the Island Judiciaries have been and remain well able to cope with the considerable workloads associated with the international finance centres.



Each of the Islands likewise has two senior *law officers*, known as the Attorney General and Solicitor General in Jersey, HM Procureur and HM Controller in Guernsey, and the Attorney General and Government Advocate in the Isle of Man.

In each Island, the law officers combine the important roles of public prosecutors, legal advisers to the Island Parliaments and supervisors (Guernsey) or advisers (Jersey and the Isle of Man) on the drafting of legislation. They have important roles, too, in relation to the provision of assistance to investigating authorities in other jurisdictions.

The law officers are assisted by 11 legal advisers and assistants in Jersey, 7 in Guernsey and [.... 1 in the Isle of Man. Separate teams of [x, y and z] specialist lawyers, respectively, are responsible for drafting of legislation. Both for prosecution and for law drafting, the Islands buy in expert resources from outside when required.

As discussed in Chapter 5, the law officers in all the Islands have a firm policy to prosecute crime wherever there is sufficient evidence and a reasonable prospect of conviction. This is clearly a key requirement in any international finance centre. So far as I am aware, the policy has not been constrained by shortage of resources.

The law officers do, however, bear heavy burdens. It is therefore crucial that they should have the resources they need. [The Guernsey team is [not only the smallest but] is also directly responsible for supervising the preparation of legislation and approving the registration of companies. In my opinion, the Guernsey authorities would be well-advised to consider taking on two or three extra qualified staff and perhaps reducing their involvement in approving company registrations.

### *16.3 Police and Customs: resources*

As indicated in the accompanying Box, the Islands employ relatively high proportions of their total populations in police and Customs work. Jersey employs 4.6 per cent of its population in such work. Guernsey employs 4.3 per cent at present, including significantly more Customs officers than the other Islands, but plans to employ extra police and civilian support which will raise the proportion to 4.8 per cent. The Isle of Man employs 4 per cent. The corresponding proportion in the UK is about [0.4] per cent.

More intuitively, perhaps, the police and Customs employ one person in 22 in Jersey, one person **in 23 in** Guernsey, and one person in 25 in the Isle of Man.

Of particular concern for the international finance centres is the allocation of resources to fraud and commercial work, financial intelligence and investigations. As in the UK, but in contrast with most European jurisdictions, the Islands' Police and Customs authorities rather than the prosecuting authorities are responsible for criminal investigations. [And the Tax authorities, too?]

The tasks undertaken by these sections include:

- Investigation of financial crime
- Obtaining evidence
- Dealing with suspicious transaction reports
- Responding to requests for assistance from other jurisdictions

## Relations with the finance sector, companies and professionals.

As indicated in the accompanying Box, Jersey now employs 11 people in these areas, including 2 Customs officers. Guernsey employs 8, again including 2 Customs officers, The Isle of Man employs 6.5, all police officers (there is one vacancy at present).

The drug trafficking intelligence bureau in Jersey, with 14 staff, and the small enforcement unit in the Isle of Man's FSC, with 3 staff, both do some work which the police might undertake in the other Islands.

In considering whether Police and Customs have sufficient resources in each of the Islands, three questions are especially relevant:

First, are they able to deal promptly and effectively with suspicion reports, including briefing and feedback to the provider institutions?

Second, are they able to respond promptly and effectively to requests for information, investigations or evidence from other jurisdictions?

Third, are they able to devote the resources needed to investigating local criminals and putting them out of business?

Taking these questions in turn, my impression is that the Jersey and Guernsey authorities probably do have the resources needed at the moment to process and investigate *suspicious transactions* and to provide feedback.

The Isle of Man authorities, on the other hand, **receive** more reports than the other two Islands, partly because of their relatively big life insurance sector, while having fewer staff to deal with them. They have therefore to operate a sifting process which is clearly less than ideal-

All the Islands have recognised the need for more resources to deal with the increase in reports which is expected when all crimes money laundering takes effect.

The Isle of Man and Guernsey have given priority to *meeting requests for assistance* from overseas jurisdictions. For the most part, their legislation has enabled them to do so. The Isle of Man's Fraud Squad spends more than half its time assisting overseas authorities,

The Jersey authorities, too, have given priority to meeting requests for assistance on drug related offences. In other areas, however, as discussed in the previous Chapter, their present legislation significantly limits the ability of the police and others to give assistance, especially at the investigation stage. The authorities have also had a policy not to assist in purely fiscal cases. [When they introduce the missing elements of legislation and change their policy on assistance in fiscal cases, as they are now proposing to do, some increase or redeployment of resources will almost certainly be needed.]

With regard to *investigating local criminals* who pose a threat to the finance centres, and putting them out of business, the Isle of Man authorities acknowledge that there is much that cannot be done within present resources. The authorities in the other two Islands have not identified this as a problem to the same extent.

The conclusions I would draw are:

All the Islands will need extra resources to deal with the expected increase in numbers of suspicious transaction reports and confiscation orders after the new **all** crimes legislation and suspicion reporting take effect. Jersey and Guernsey have provisionally estimated a requirement for 2 extra staff.

The Isle of Man seems to have a special need for extra staff in this area. The requirements discussed above suggest that not less than 4 extra staff are needed, in addition to filling the present vacancy and an extra 2 staff for the all crimes suspicion reporting. The Head of the Fraud Squad would preferably be a full-time post as well.

The Jersey authorities are likely to need some more staff in this area as they introduce their proposed new legislation and policies. In their case, however, it might be possible to find these through some redeployment of resources.

The Guernsey authorities, too, will probably need to allocate some of the increase in police numbers now proposed to these important tasks.

The policing and regulation of the international finance centres place considerable burdens on the Islands. The FSCS, the Fraud and Financial Investigation Units and the Prosecuting authorities between them employ between [55 and 65] people in each of the Islands. The Fraud Squad in the Isle of Man spends more than half its time responding to requests for assistance of all kinds from other countries. In Jersey and Guernsey, too, the commitment is heavy.

But the Island authorities accept that they have an absolute obligation to police and regulate their international finance centres to the highest standards, to co-operate with overseas authorities and to make the necessary resources available.

#### *16.4 Police and Customs: structures and financing*

Both Jersey and Guernsey have small *Financial Investigations Units (FIUs)*, jointly staffed by 2 police and 2 Customs officers, which deal with suspicious transaction reports and requests for assistance from overseas jurisdictions. As explained above, the staff in both units will be increased by 2 to deal with the expected increase in suspicious transaction reports when the all crimes money laundering laws take effect.

Jersey also has a substantial *Drug trafficking intelligence bureau* employing 14 staff.

The Isle of Man does not have a joint Financial Investigation Unit. Customs operate separately from, though in close consultation with, the police. The police's *Fraud Squad* undertakes most of the tasks undertaken elsewhere by the Joint FIUs. It acts as the receiving house for suspicious transaction reports and requests for assistance from overseas.

In my opinion, there are strengths as well as weaknesses in all the Islands' structures. Jersey and Guernsey seem to me right to have joint financial intelligence and investigation units bringing together police and Customs. The Isle of Man seems to me right to have a single unit dealing with fraud as well as financial intelligence and investigation.

The Island authorities have been considering further reforms of structures. In my opinion,

there is a strong case for reforming the structures along the following lines:

*Single, self-standing units.* The aies of the present Fraud Units and Financial Investigation (and Intelligence Units and possibly Drug Trafficking Intelligence Bureau in Jersey) be brought together into single self-standing units, which might be known as Finance Crime Units

*Responsibilities.* The Units would be responsible for policing the Islands' finance centres and supporting the Attorney Generals in their role as public prosecutors for the finance centres.

*Tasks.* Specific tasks would include, intelligence, handling of suspicious reports, maintenance of a comprehensive database, investigation of financial crimes including money laundering and tax evasion, obtaining of evidence, seizures, restraints and confiscations, relations with finance, company and professional sectors, and assistance to other jurisdictions.

*Multidisciplinary Units.* The new units would (preferably like the Northern Ireland Terrorist Finance Unit) be multidisciplinary units including Customs and direct tax staff as well as police officers, policy, accountancy and information technology support. Professional assistance would continue to be brought in from outside as required

*Full-time Heads.* The Directors of the units would be full-time They would not have other responsibilities.

*Reporting lines.* The Units would be separate from the Police, Customs and Attorney General's Offices. But the Director would report to the Attorney General, with a dotted reporting line to the Chief Constable.

*Links with other agencies.* The Units would work in close co-operation with the Attorney General's office, the Police. Customs, the Tax departments and the financial regulators.

*Dedicated financing.* The Units would be financed separately from the Police and Customs. The Attorney Generals would be responsible for ensuring that budgets and staffing were adequate to provide effective policing of the finance centres and support for the prosecutors. The Chief Constables or the Police Committees would no longer have the difficult task of dividing resources between the policing of the finance centres and general policing.

*Staff and training.* Staff would be encouraged to make careers in this important but specialist area of work. They would no longer be required to move back and forth between this and other policing work. Special priority would be given to training programmes, including UK programmes.

Dedicated financing is not the least important element in this prospectus. In my opinion, Chief Constables and Police Committees are not well placed to determine the allocation of resources between fraud, financial crime and assistance to other jurisdictions, on the one hand, and general policing on the other. The Police are always under pressure, quite understandably, to give more resources to physical crime and neighbourhood policing. Switching resources from this area to financial crime will always be difficult. The present allocation mechanisms are very likely, therefore, to lead to under-resourcing of finance centre policing.

## 16.5 Comparison with the UK and Other Countries

It must be acknowledged that an integrated structure on the lines suggested would be very different from present UK structures.

In the UK, there is a National Crime Intelligence Service, NCIS, jointly staffed by the Police and Customs with some involvement of other Departments. There are separate Customs and Police units for investigation of drug trafficking and organised crime. There is a Serious Fraud Office which investigates and prosecutes a limited number of serious or complex cases. And there are more than 50 fraud squads, independent of each other, which come under the Chief Constables and Police Authorities of the individual Police Authority areas.

The Police Authorities, and Chief Constables are responsible for determining what priority, resources and budgets should be given to the pursuit of financial crime by fraud squads as against other forms of crime. And police staff mostly do short periods of duty in these specialist areas.

There are two main comments that should be made on the differences between present UK models and those suggested above for the Islands.

First, the Islands have options, because they are small, that the UK and other large jurisdictions do not have. One such option is that they can if they wish bring closely related functions together in one Unit. These functions would ideally be brought together in all countries. This is not, however, a realistic option in the major countries because the resulting units would be impossibly large.

Second, the many professionals I consulted seemed mostly to feel that the UK's own structures for dealing with fraud and financial crime, and the systems for resource allocation, are anyway far from ideal. There seemed in particular to be a broad consensus on the case for a National Fraud Squad including permanent specialist staff of various disciplines and financed independently of the local police forces.

## **17 INTERNATIONAL STANDARDS**

### *17.1 Introduction*

The Island authorities all have a clear objective that their finance centres should be the best of offshore centres, not only in terms of quantity and quality of business but also in terms of international standards of regulation, policing and co-operation. Earlier Chapters have been concerned, directly or indirectly, with how the Islands can achieve and sustain such standards.

There are, however, three anxieties that the Islands have constantly to face in the quest for standards:

First, there are fears that higher standards of regulation, policing and co-operation will lead to *loss of business*, not just disreputable business whose loss will be welcome but also reputable business from clients who see the privacy of their affairs as threatened. This was a constant refrain in my discussions with the authorities and practitioners in the Islands.

Second, the Islands may receive no international credit or recognition for high standards. Busy regulators, law enforcers and practitioners in the rest of the world will often not appreciate the

lengths to which the Island authorities have gone. The incentive to improve standards may therefore be diminished.

Third, the Islands' reputations are liable to suffer *from jaundiced perceptions of offshore* centres generally, even when the Islands themselves are beyond reproach. This suffering by association may exacerbate the credit shortfall.

### *17.2 Anxieties over loss of business*

Taking these anxieties in turn, the authorities in any finance centre have clearly to accept (as the Islands do) that, when regulation is improved, some good business may initially be lost as well as bad. That cannot, however, excuse poor regulation. In the longer-term, moreover, good regulation is likely to attract more business than it drives away. The UK and European financial institutions who are the largest source of Island customers will on the whole be strong supporters of good regulation provided that it is not over-regulation.

Anxieties about loss of business will be further allayed if improvements in regulation can be implemented at about the same time throughout the offshore. As discussed below, therefore, the Islands have been keen to promote co-operation between the offshore centres and a level playing field.

## BOX

LAW ENFORCEMENT RESOURCES AND STRUCTURES  
*member of full-time equivalent staff in post, including civilians, March 1998*

	<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of Man</i>
<i>Police</i>			
<i>Uniformed</i>	-	149*	213
	340		
<i>Other.</i>		36*	33
<i>Customs and Immigration</i>	53	67	44
<i>TOTAL</i>	393	252	290
<i>Total as % of population</i>	4.6	4.3	4.0
<i>Of which:</i>			
<i>Fraud/Commercial units     (police)</i>	7	3.5	
Financial investigations unit (part of police fraud unit in IoM, joint unit in J & G)	4**	4.5**	6.5
Drug trafficking intelligence bureau (J only, joint unit)	14	-	

## NOTES

\* Guernsey is committed to adding 5 civilians immediately and 28 officers over the next three years.

\*\*Jersey and Guernsey propose to allocate 2 extra staff when the all crimes money laundering provisions take effect.

### *17.3 International recognition: accreditation*

International recognition of high standards of regulation is likely to enhance the benefits to the Islands. The Island authorities have therefore been keen, rightly in my view, to promote such recognition.

There are two main forms that recognition can take:

International accreditation of regulatory and counter-crime standards by the main international institutions and associations, and

favourable treatment by the large countries of individual small jurisdictions that meet certain regulatory and counter-crime standards.

*On accreditation*, some progress has been made and the Islands have been prominent in pressing for it:

The international *Financial Action Task Force* (FATF), set up by the G7 and the OECD in 1990 to combat money laundering, does not admit small jurisdictions to membership. It has, however, encouraged the development of a network of similar regional Task Forces in other parts of the world, mostly including a FATF member. It has encouraged the Offshore Group of Banking Supervisors (OGBS) to extend its activities to include the combating of money laundering.

The FATF has invited these other Task Forces and the OGBS to subscribe to the Forty Recommendations of the FATF and submit themselves to inspection by mutual evaluation groups, including experts from FATF countries. All OGBS members except Lebanon have responded positively and the OGBS has agreed to include Justice, Customs and FIU professionals in its deliberations.

The Crown Dependencies have set an example by inviting evaluation groups to inspect their systems. Jersey, for example, [has invited representatives from the US, France and Holland to undertake this task]. The inspections are due to take place in the autumn.

*The Egmon Group* of professionals from national crime intelligence and investigation units includes the Islands among its membership.

The *Basle Committee of Banking Supervision*, while restricting its membership like the FATF to the large countries, has recently agreed that experts from member countries may take part in peer group reviews of whether OGBS members' banking supervision meets the Basle "core principles" for effective banking supervision, though they have to limit themselves to factual matters. The OGBS Group itself then makes an evaluation, based on the factual analysis.

In practice, the central banks and supervisors of the major countries have been hesitant to take part for reasons of moral hazard. The search has therefore switched to retired supervisors. Some OGBS members themselves have been reluctant to volunteer for inspection. The process has been slow in getting off the ground.

The International Organisation of Securities commissions, IOSCO, accepts smaller jurisdictions as associate members. All the Islands are associate members. The Island authorities take part, therefore, in IOSCO's deliberations and self-evaluation exercises. [Do these happen and what do they achieve?]

*The International Association of Insurance Supervisors, IAIS*, likewise accepts smaller jurisdictions as members. The Islands are [all] members of IAIS, too. [Does it do anything?]



The Islands have also been instrumental in the establishment of an Offshore Group of Insurance Supervisors to match the OGBS, which undertakes mutual evaluations.

Promising as these activities are, the systems for international co-operation have not yet developed to the point where there is a clear distinction in all the main areas of regulation and counter-crime systems between accredited and non-accredited countries, based on rigorous criteria consistently applied. For onshore as well as offshore centres, the international institutions have been anxious to avoid the moral and practical hazards of endorsing (or appearing to endorse) standards of regulation. In many parts of the world, moreover, countries have not been eager to submit their systems for evaluation.

A further lacuna is that there are no international bodies or forums that set and monitor standards in the critical areas of Trusts [? and companies].

In my opinion the Islands have been right to press for progress on international accreditation and should continue to do so. The UK would be well placed to promote establishment of an international forum on Trusts.

#### *17.4 International recognition: favourable treatment*

With regard to *favourable treatment of high-standard jurisdictions* by the larger countries individually, there is scope for the larger countries to grant such jurisdictions market access and other privileges, in return for high standards of regulation and co-operation. Some examples of this are:

The UK's grant of "designated territory" status under section 87 of the Financial Services Act 1986 to jurisdictions wishing to promote authorised *collective* investment schemes to the general public in the UK;

The UK's similar grant of designation under section 130 of the Financial Services Act 1986 for *life and pensions insurers*

[All three] Islands have designated territory status in each area. This enables them to market investment, insurance and pension products to UK residents which non-designated providers outside the EU would not be permitted to do [Do the EU countries, e.g. Holland, or the US extend any similar privileges?]

Tax authorities, too, in the larger jurisdictions have some scope to promote high standards internationally by designating co-operative jurisdictions and facilitating taxpayers' business with them. [The US authorities explicitly differentiate between more and less co-operative jurisdictions. They apply more stringent enforcement procedures, and tax penalties, to those of their taxpayers who have dealings with low-standard, unco-operative jurisdictions.]

These instruments for promoting and recognising high standards seem to me potentially powerful. The scope for the larger countries to develop them further seems considerable.

#### *17.5 Suffering by association*

The Islands' problem of suffering by association, from jaundiced perceptions of the offshore generally, is probably not susceptible of a complete solution. The policies for accreditation and

positive discrimination discussed above, if they can be developed, should help to alleviate the problem by reducing public perceptions that offshore jurisdictions are all alike. But they will not solve it totally.

The other means to alleviate the problem, clearly, is through the *promotion of high standards in the offshore generally*.

In this, too, the Islands have taken a leading role. The Jersey authorities in particular have been instrumental in developing the role of the Offshore Group of Banking Supervisors (OGBS) and in developing the Group's involvement in the FATF processes for combating money laundering. Jersey's Chief Adviser has been Chairman of the Group since 1981. The OGBS was the first to be established of the regional groups linked to the Basle Committee and remains the only one that has sought to establish entry standards. The Guernsey authorities have been instrumental in developing a parallel Offshore Group of Insurance Supervisors.

These Groups have a considerable potential to promote high standards and improve the reputation of offshore centres generally through application of peer-group pressure. In this they have been partially successful, but only partially.

Some particular problems with the OGBS have been:

*Membership.* In all such groups, there's a dilemma whether membership should be universal (so as to maximise the benefits that flow from regular meetings with counterparts and eye-ball to eye-ball contacts) or selective (so as to differentiate the sheep from the goats).

The OGBS have not so far succeeded in resolving this problem. Their membership of 19 (see Box 17. 1) does not include a comprehensive coverage. The British Virgin Islands, for example, are not a member. In recent years, the Group has rejected applications for membership from [5?] offshore centres. On the other hand, the Group has allowed a similar number of existing members to remain as members-even though they appear to fall short of the endorsed by the Group.

A possible solution might be to combine comprehensive coverage with selectivity through a system of members and associate members.

*Speed of progress.* The Group has found it difficult in practice to make progress. The first round of FATF-style evaluations is only now beginning, though some members are covered by the Caribbean and Council of Europe evaluation networks. At present rates of advance, it will be many years before a single round of mutual evaluations has been completed. [Are there any Basle based evaluations?]

Appointment of a paid working Chairman devoting much of his time to the Group's affairs might help to accelerate the pace of advance.

*Subject coverage.* Although the OGBS has taken on a role in relation to money laundering and FATF-style evaluations, it does not cover all aspects of the regulation and policing of offshore centres.

There may be a case for developing a new structure comprising an Offshore Steering Group (OSG) at senior level with sub-committees as necessary for individual areas of regulation or counter-crime.

*Interlocutors valables.* It would be helpful to develop more regular contacts between onshore and offshore. When the large countries meet to discuss issues such as drug trafficking, money laundering, international aspects of supervision and international co-operation, for example, they could usefully make a habit of inviting an OGBS representative to represent the offshore.

For onshore and offshore alike, moreover, there could be advantage in periodic discussions between representatives of the OSG and a suitable body from the onshore jurisdictions. The latter body might bring together representatives of "parent" countries of offshore centres, other interested countries or country groupings (such as the US, the OECD and the EU) and international financial bodies (such as the IMF). A forum on these lines could help to build a more constructive relationship between the onshore and offshore worlds.

The UK, as the parent or former parent country for many offshore Jurisdictions, might be well-placed to convene such a forum.

### *17.6 Fallback option*

If the various approaches discussed above do not bear fruit, there could be a case for the UK, the Islands and the British Overseas Territories to set up a small independent *Financial Centres Audit Office (FCAO)*, somewhat along the lines of the Audit Commission in the UK.

An Office on these lines would have no executive powers, In close co-operation with the Island authorities, however, it might:

*maintain a professional prospectus for each Island's legal, regulatory and counter-crime frameworks, systems and practices, possibly along the lines of parts 2 to 4 of the present report;*

*audit the Islands' regulatory and counter-crime systems and practices on a regular basis, through a rolling programme of periodic reviews of particular areas (such as banking regulation, company registrations, Trust service providers, money laundering systems); and*

*review with the Island authorities and report on particular issues of importance and particular problems as they arise*

In the absence of effective international arrangements, the existence of such a body might help the offshore centres associated with the UK to achieve high standards, a level playing field and an enhanced reputation compared with other offshore centres.

In my opinion, the better course would be to develop international co-operation, accreditation and recognition along the lines discussed earlier in this Chapter. An FCAO should be considered only if this falls.

## **18 CONCLUSION**

### *18.1 General assessment*

The main conclusions from the Report appear in the Summary and Main Recommendations at the beginning.

In my assessment, as discussed in Chapter 2, the development of the Islands' international finance centres, especially over the past 20 years, has been a remarkable success story. They have infrastructures of legislation, judiciary, prosecution, regulation and law enforcement, mostly based on UK models, which for the most part are remarkably good for such relatively small jurisdictions. In many areas they have co-operated well, sometimes remarkably so, with the authorities of other countries in the pursuit of crime and regulatory breaches.

The Island authorities recognise the need for progress in certain key areas. In all cases, they have identified the importance of:

extending the regulatory boundary to encompass Trust and Company service providers,

successful implementation of the All Crimes Money Laundering regimes and related legislation so as to enable the fullest co-operation with overseas authorities in the pursuit of crime, and

adequate resourcing of the regulation and Policing of their finance centres.

In other areas, the strengths, needs and priorities vary somewhat from Island to Island:

*In Jersey*, the banking, fund management and Trust sectors have been tremendously successful. Improvements are needed in several aspects of financial regulation, and companies operating but not incorporated in the Island need to be registered. But the authorities' most urgent requirement, in my opinion, is to reach a position as soon as possible where they can and do cooperate fully with other countries in the combating of crime of all kinds, including tax evasion and lesser frauds, not least at the investigation stage. This will involve, among other things, early passage of the missing PACE and International Co-operation Laws as well as the Proceeds of Crime Law.

*In Guernsey*, the captive insurance sector has been a particular success alongside banking, fund management and Trusts. The authorities are about to introduce a Stock Exchange. As in Jersey, certain aspects of financial regulation need to be developed further, and companies operating but not incorporated in the Island need to be registered. The Law Officers and legal draftsmen need more staff. The most urgent requirement, which the authorities are already tackling, is the proposed legislation and subsequent regulation to deal with the problem of bogus Directors and the 'Sark Lark'.

In the *Isle of Man*, the life insurance sector has made good progress alongside healthy banking, fund management and captive insurance sectors. On the regulatory side, the enforcement operation has been a particular success, and the Island has successfully implemented its depositor protection scheme. As in the other Islands, there are certain aspects of financial regulation where improvement and resources are needed, and the Trust law needs some attention. But the urgent requirement is to improve regulation of the Island's large company sector and its considerable population of company and Trust service providers.

## *18.2. Responses to concern expressed*

The Island authorities will need also to consider carefully and, where appropriate, address the concerns, summarised in Chapter 3, which professionals, customers and others associated with the Islands raised with me. Taking these in turn,

The suggestions in Chapter 5 should, if implemented, do much to alleviate residual concerns about conflicts of interest.

The proposals in Chapter 6 for Customer Protection schemes and a Financial Services Ombudsman should do something to alleviate the perceived absence of any realistic means of redress, short of extended Court processes, for customers in dispute with institutions or professionals in the Island.

The Islands' proposals for regulation of Trust and Company service providers, provided that they are developed, implemented and resourced in the ways discussed in the Report alongside the necessary improvements in the regimes for companies, should squarely address the concerns that

- (a) firms and individuals with questionable track records are continuing in business,
- (b) some of them are facilitating tax evasion and other forms of crime,
- (c) too little is known about many of the companies operating in the Islands or using the Islands' names, and
- (d) certain Island Directors are bringing the Islands into disrepute.

The firm commitment of the Island authorities to co-operate fully with other countries in the pursuit of crime of all kinds, including tax evasion, together with passage of the outstanding enabling legislation, should go a considerable way to allay concerns that the Islands are depriving other countries of tax revenues. The issue of harmful tax competition within the law is beyond the scope of the Report.

The same commitments by the Island authorities, and passage of the same enabling legislation, together with the proposed resourcing and structural improvements, should mean that all the Islands will co-operate (or continue to co-operate) in an exemplary way with overseas authorities in the pursuit of crime and regulatory breaches.

### *18.3 Resources*

The Report has identified needs for extra skilled staff in several areas to police and regulate the Islands' international finance centres. The Box 1 table, based on the discussions in earlier Chapters, indicates a requirement for a total increase of between 15 and 20 staff *gross* in each Island.

It should be possible to meet some of the requirement by redeployments from elsewhere. There might, for example, be some redeployment of staff [from the drugs intelligence unit in Jersey, from Customs and the increase already proposed in police numbers generally in Guernsey, and from other areas of police work and merging of the regulatory agencies in the Isle of Man].

### *18.4 Timetable of implementation*

Box 18.2 indicates the timetables [proposed by the Island authorities for completion of the main legislation and policy changes if approved by the Island Parliaments].

On these proposals, the Islands would have implemented by the end of 2000 all the legislative and policy changes discussed in the Report except where they are contingent on prior action by the UK.

In my opinion, these timetables look reasonable. It will be important to adhere to them.

**BOX 18.1**  
**STAFF REQUIREMENTS INDICATED BY THE REPORT**  
Increase in full-time equivalents, gross

	<i>Jersey</i>	<i>Guernsey,</i>	<i>Isle of Man</i>
Support for Law Officers		2	
Police and other staff for Fraud and Financial Intelligence and information Units (FFIIUS)	4	3	7
Registration of Companies not locally incorporated, returns of beneficial ownership, filing of accounting information, enforcement	3	3	3
Regulation of banks, investment business & Stock Exchange	3	3	4
Regulation of insurance	0.5		
Regulation of Trust and Company service providers	5.5	4	5.5
Enforcement	3	1	
Customer protection and support to Ombudsman	1	1	0.5
<b>TOTAL</b>	<b>20</b>	<b>17</b>	<b>20</b>

**BOX 18.2**  
**TIMETABLE FOR IMPLEMENTATION**  
\*Requires no legislation or only minor legislation.

\*\*Requires major primary legislation or treaty

<i>1998</i>	<i>Jersey</i>	<i>Guernsey</i>	<i>Isle of Man</i>
Conflicts of interest	*	*	*
All Crimes Money Laundering	**	**	**
Removal of prosecution time-bar	*	*	*
Financial crimestoppers line	*	*	*
<i>1999</i>			
PACE law	**		
International Co-operation law	**		
Removal of fraud & ACML thresholds	*		
Regulation of Director services		**	
Changes to Law on Purpose Trusts			**
Insurance Law and regulation changes	**	**	**
FSC and Regulatory, changes. inc Board and structural changes. on-site inspections and staff recruitment	*	*	*
Company regulation changes. inc action on beneficial ownership and nonresident companies (IoM), registration of companies incorporated elsewhere (J,G) & LLPs			
disclosure regime (J)			
Insolvency legislation	*	**	**
New Double Taxation or Exchange of information Agreements	**	**	**
Establishment of separately financed FFIUs	*	*	*
Complete recruitment of new staff for FFIUs & FSCs & LOs	*	*	*
<i>1999 or 2000</i>			
Improve Trusts legislation	**	**	**
Licensing & Regulation of Trusts and Company Service providers	**	**	**
Customer Protection Schemes	**	**	**
Financial Services Ombudsman	**	**	**
Investment business legislation changes	*	*	*
Rules of financial business conduct	*	*	*
Finance centre training	*		*
<i>TIMING CONTINGENT ON UK ACTION</i>			
Remove ACML indictable offences limitation		*	*
General law on co-operation. gateways etc.	**	**	**
Measures to take profits out of crime:	**	**	**

unexplained life-styles/ use of law powers