

Off-shore Group of Banking Supervisors

Mutual Evaluation Report

The Anti-Money Laundering System in the Isle of Man

I. Introduction

- 1.1 This Report summarises an evaluation of the anti-money laundering environment in the Isle of Man. The evaluation was conducted under the aegis of the Off-shore Group of Banking Supervisors (the OGBS).
- 1.2 The report is organised as follows:
- Part I describes the evaluation process.
 - Part II provides some background; including a brief description of the financial sector, and the respective roles of the authorities which have responsibility for the anti-money laundering system on the Island. It concludes with the evaluators' assessment of the nature of the threats posed by money launderers.
 - Part III provides a description and assessment of the legal provisions in place in the Island to counter money laundering.
 - Part IV evaluates the response by the law enforcement authorities;
 - Part V provides a description and assessment of the role of the financial regulatory regime;
 - Part VI is a summary, intended for publication.
- 1.3 The evaluation team comprised:
- **Dominique Gaillardot**, Magistrat, Traitement du Renseignement et Action Contre les Circuits Financiers Clandestins (TRACFIN), FRANCE (Law Enforcement Expert);
 - **Theodore Greenberg**, Special Counsel, International Money Laundering, Department of Justice, UNITED STATES (Legal Expert);
 - **Milena McLean**, Director (Banking and Investment Services) Malta Financial Services Centre, MALTA (Financial Expert);

- **Andrew Lewis**, Financial Crime Branch, HM Treasury, UNITED KINGDOM (Secretary).

- 1.4 The team visited the Isle of Man on the 19th and 20th July 1999, and met representatives of each of the authorities listed in paragraph 2.14 below. In advance of the meeting the team had received a full response to the evaluation questionnaire, which was supplemented by other detailed material provided both before and during the visit, and also by the response (received after the visit) to a set of more detailed written questions. The team also held discussions with representatives of the financial sector.
- 1.5 The team is very grateful indeed for the hospitality extended to its members during their visit to the Island, for the comprehensive materials provided by the authorities before, during and after the visit, and for the open way in which everyone involved approached the evaluation.

II. The nature of the Isle of Man's anti-money laundering system

The constitutional position

- 2.1 The Isle of Man lies in the middle of the Irish Sea, with a population of 72,000 people. It is a Dependency of the British Crown, and is not part of the United Kingdom. The Isle of Man is not a member of the European Union although, through a protocol to the Act annexed to the 1972 Treaty of Accession of the UK and others, Community rules relating to customs and quantitative restrictions and certain rules relating to trade in agricultural products apply to the Isle of Man. It is not, however, part of the single market in financial services and, as a result, is not covered by the EU Money Laundering Directive. The Isle of Man joined the OGBS in the late 1970s.
- 2.2 The Island has a very substantial degree of independence from the United Kingdom. Manx Legislation requires Royal Assent from the British Monarch, but the UK's Parliament has no authority on the Island. However, as a matter of policy, the Isle of Man Government models its legislation on the UK's, and tends to amend its legislation in response to developments in the UK. Precedent set by English Common Law has influence in the Island's courts, but is not regarded as binding. The Island has its own direct and indirect tax system, although indirect taxes are generally set in line with, and subject to similar rules and procedures as in the UK. The system of financial regulation and the powers of the law enforcement authorities are different from those that apply in the UK, although there are close linkages.

The Financial Services Sector on the Isle of Man

- 2.3 Table 1 provides some statistical information about the Island's financial services sector. A significant and growing off-shore financial sector exists. There are currently 65 banks and financial institutions operating in the Island. The Island hosts a number of branches/subsidiaries of Irish, American, European, Indian, and other

Eastern and UK Institutions. The banking sector is, however, smaller than in each of the Channel Islands.

- 2.4 There are 16 authorised and 85 restricted collective investment schemes. These together with an unknown number of "exempt restricted schemes" had £7.5 billion under management as at March 1998. 54 institutions or professionals are licensed to conduct investment business and in addition there are 32 Recognised Persons who are able to carry out investment business. There are also 22 fund management licensees and 5 third party administrators. The Island has an extensive life assurance industry, and a significant general insurance sector (mainly dealing with captive insurance). The Island is also a major centre for the registration of companies, and has a significant trust sector.

<i>Table 1. A summary of the Isle of Man's financial services sector</i>	
Banks	
Number of licenced banks (+building societies)	65 (+3)
Value of assets	£22.85 billion
Investment Business	
Licenced schemes	101
Total funds	£7.5 billion
Insurance	
Number of Companies: general insurance	180
: life assurance	15
Assets : general insurance	£4 billion
: life assurance	£7 billion
Premium Income : general insurance	£900 million
: life assurance	£1.5 billion
Companies incorporated	42,000
GDP Per Head	£8,930
% of GDP attributed to financial services	39
% of Workforce in Financial Services	19
<i>Appendix B provides a comparison of these figures with the other UK Crown Dependencies</i>	

- 2.5 The vast majority of the financial transactions are conducted with and between non-residents. In the past this business was heavily oriented towards the UK, with the Island acting as a "staging post" for investment from the rest of the world into the UK. A high proportion of bank deposits were owned by UK citizens. While UK citizens remain the single largest client base, and sterling the most common currency, the Island's business is becoming increasingly international. This is particularly true of the Island's life assurance and company sectors.

2.6 International investors are attracted to the Island because of its comparatively benign tax regime and its political stability, an extensive infrastructure of professional services, and good links to institutions in the UK and Europe. However, there are also (limited) examples of Isle of Man financial institutions using client confidentiality and secrecy as selling points, even though the Isle of Man has no special secrecy laws of the type encountered in some jurisdictions.

2.7 The Isle of Man has no dedicated Bureaux de Change, although a couple of travel agents exchange currencies for travel purposes. Although these are covered by the Money Laundering Code (see 5.2 to 5.4 below), currency exchange is not subject to supervision. There is one casino, for which the Gaming Board has supervisory responsibility. A significant telephone betting industry with an annual turnover of around £90-100 million has recently been established. Lawyers and accountants are supervised by their own professional bodies.

The money laundering threat

2.8 Statements by the island's authorities and intelligence suggests that the degree to which Isle of Man financial institutions are used to launder the proceeds of crimes committed locally is small. While the Island has a low crime rate, there is a relatively small - but growing - problem with illegal drugs, generally imported from the UK. Intelligence also suggests that local drug suppliers are not making material profits. Custom controls are in place at access points to the Island; x-ray machines are employed at the sea ports and post office, as well as at the airport.

2.9 Large cash deposits are rare, and therefore the attempt to lodge even a modest amount of cash into the financial system is likely to be regarded as suspicious. Placement by money launderers was thought by the authorities on the Island to be a negligible risk. In 1997 the Customs, in conjunction with their counterparts in the UK, undertook a survey to identify large imports of cash over the course of a single week. The results confirmed their view that suspicious cash movements were rare. Nevertheless, paragraphs 3.10 and 3.11 of this report considers the case for further steps to prevent cash placement.

2.10 While the risk at the placement stage is low, the relative risk at the layering and integration stages is significant. The volume and nature of the business conducted on the Island, the Island's relationship to the major financial centres in the UK and elsewhere, and the perception of its role as "Offshore Europe", make the Isle of Man a potential staging post for funds at the layering stage. Its good reputation among off-shore centres, and the respectability provided by its political and constitutional status, makes the Isle of Man potentially useful at the integration stage, when money launderers seek to add apparent legitimacy to their funds.

2.11 Historically the most common money laundering mechanisms employed in cases investigated by the Island's authorities involved the use of sham companies, often with false invoices and fraudulent documentation. The authorities' assessment is that corporate service providers, including those who provide nominee director services, are at risk of being used for money laundering purposes.

The Island has recognised this weakness and intends to introduce new legislation that will see corporate service providers regulated by the FSC (see 5.18 to 5.20 below). The insurance sector also represents a significant opportunity to would-be launderers. The life assurance business managed on the Island is truly global, with a number of companies conducting business with clients in countries and regions sometimes considered a source of significant criminal proceeds.

- 2.12 Since the Island's private banking and trust sectors provide professional and banking services to very wealthy overseas clients, they may in particular be susceptible to abuse by launderers. The potential for abuse, especially at the layering and integration stages, means that professionals, lawyers, accountants, and company and trust service providers are in the front line of the Island's defences against money laundering. Long-standing clients, who might be regarded by their professional advisors on the Island as being "above suspicion" should not be overlooked. Since a proportion of the Island's business is generated by the tax minimisation strategies of companies or wealthy individuals, there is a real risk that apparently uneconomic transactions are attributed to tax avoidance, and that financial intermediaries will under-declare suspicions of tax evasion (the so-called "fiscal excuse").
- 2.13 In the opinion of the Evaluation Team, the Island's authorities have a realistic understanding of the risks that their jurisdiction faces from money launderers. The Team endorsed their assessment that cash placement was now a negligible issue, albeit one that requires continued monitoring. The Team also believes that a meaningful appreciation of the relationship between tax evasion and money laundering exists - as does the recognition that the "fiscal excuse" is a genuine issue of concern (the evaluators' view is that instruments to facilitate legal tax avoidance can also be of use to money launderers). There was no indication of complacency by the authorities, nor by the representatives of the private sector whom the Evaluation Team met. Nor was there any attempt on the part of anyone interviewed to play down the risks. The Team detected pessimistic views about the extent to which anti-money laundering systems can be successful in "layering jurisdictions". There was also a feeling that the nature of the financial business on the Island limited the extent to which authorities and the financial sector could be pro-active in the detection of money laundering. This issue is picked up later in this report, where the scope for a pro-active enforcement strategy by the Island's authorities is considered (paragraph 4.14 below).

Responsibilities

- 2.14 Responsibility for the anti-money laundering system in the Isle of Man is allocated as follows:
- The **Attorney General**, a UK Crown appointment, is the Isle of Man's senior law officer. He has statutory powers for the investigation of serious and complex fraud, and prosecutory powers in respect of money laundering offences. His office acts as the Central Authority in mutual assistance matters, and is responsible for reporting to the competent authorities in the United Kingdom of suspicious transaction reports to authorities outside the jurisdiction.

- The **Fraud Squad of the Isle of Man Constabulary**, soon to be superseded by a Financial Crime Unit, administer the suspicious transaction reports system, and is responsible for money laundering investigations that fall outside the responsibility of Customs. The Police also have a role in training and raising awareness of money laundering issues within the financial sector. There are currently 8 officers in the squad, which can also call upon the services of a lawyer and a chartered accountant.
 - The **Isle of Man Customs and Excise** controls entry through the ports and airport, and is responsible for investigations involving drug trafficking, value added tax and excise fraud, including where these offences give rise to money laundering. Customs also have a role in anti-money laundering training and testing for compliance with the Anti-Money Laundering Code as part of their routine Assurance Visiting Programme. Under the law, Customs' officers are defined as "constables", and are therefore able to receive suspicious transaction reports. There are 4 investigators whose priority is to conduct anti-money laundering enquires, 4 intelligence officers (one of whom liaises with the Police over suspicious transaction reports) and 8 assurance officers.
 - The **Financial Supervision Commission (FSC)** is an independent statutory body - responsible for the regulation of deposit taking institutions, investment business and collective investment schemes. Once proposed legislation has been introduced, FSC will also assume responsibility for the regulation of company service providers - currently unregulated (see paragraphs 5.18 below). The Enforcement Division is responsible, inter alia, for producing and enforcing the anti-money laundering guidance notes. Responsibility for the Companies Registry has recently been transferred to the FSC.
 - The **Insurance and Pension Authority (IPA)** is responsible for the regulation of general insurance and in due course pension business, including branches of foreign-incorporated companies, and insurance intermediaries operating in or from the Island. The IPA issues anti-money laundering Guidelines to insurance businesses (see 5.11 to 5.15 below).
- 2.15 Since 1998 there has been a Money Laundering Liaison Group, consisting of representatives from each of the above-named organisations. The Group meets regularly to exchange intelligence, plan strategies and to coordinate policy and training.

III. Anti-Money Laundering Legislation

- 3.1 The legislation criminalising money laundering has evolved over time - developing from the recognition of drug trafficking offences as predicate offences, to terrorist funding, and to the new all-crimes primary and secondary legislation. In each case these steps have followed very similar legal developments in the United Kingdom.
- 3.2 The most important statutes are:

- The Drug Trafficking Offences Act 1987 - which introduced powers to require the production of information and documents, restrain and confiscate the proceeds of drug trafficking, and made it an offence to assist another to retain the benefits of drug trafficking;
- The Prevention of Terrorism Act 1990 creates the offence of assisting in the retention or control of terrorist funds, and the concealment or transfer of such funds;
- The Criminal Justice Act 1990 extended the confiscation powers to all crimes, and allowed the Isle of Man to assist other jurisdictions. It also gave the Attorney General substantial investigative powers in respect of "serious and complex fraud". In practice the relevant offences were defined very broadly. The Act has been used to enable cooperation on a relatively wide range of international enquiries into financial crime;
- The Criminal Justice Act 1991 allows the Isle of Man to meet the requirements of the Vienna Convention, and included powers to enable mutual assistance in criminal matters on the same basis as set out in the European Convention on Mutual Assistance in Criminal Matters (Strasbourg 1959);
- The Drug Trafficking Act 1996 consolidated and extended the 1987 Act to include the offence of failing to disclose the knowledge or suspicion of the laundering of the proceeds of drug trafficking, and of prejudicing an investigation by tipping off;
- The Criminal Justice (Money Laundering Offences) Act 1998 extended the Criminal Justice Act 1990 to criminalise the laundering of the proceeds of all serious crimes, and introduces the Anti-Money Laundering Code.

3.3 Until the introduction of the Criminal Justice (Money Laundering Offences) Act 1998 ("the 1998 Act"), there were significant gaps in the anti-money laundering powers available to the authorities. Effective international cooperation was limited to certain offences: drugs, terrorism and serious and complex fraud (albeit widely defined). The responsibility to report suspicious transactions was limited to suspicions of drug and terrorist offences.

3.4 Following the introduction of the 1998 Act, the main features of the Isle of Man's legislation are as follows:

- **Conduct captured by the legislation.** It is an offence (a) to assist another to retain, (b) to acquire, possess or use, and (c) to conceal or transfer the proceeds of criminal conduct, knowing or suspecting them to be so. The offence covers laundering one's own proceeds, and can be applied to bodies corporate. The maximum penalty is 14 years imprisonment and/or a fine.
- **Triable offences.** The 1998 Act provides that all offences under the Act are "information" offences triable on "information" (i.e. indictment), in other words all offences that

may be tried before a judge and jury. Overseas offences are covered where, had the equivalent conduct occurred in the Isle of Man, it would have been a predicate offence. The authorities believe that the proceeds of domestic and overseas tax offences are therefore captured. There is also a facility for the authorities to introduce secondary legislation to include particular summary (i.e. non-indictable) offences, although this power has yet to be used. "Either way" offences that can be tried summarily or on indictment are covered.

- **Confiscation.** The Isle of Man is able to restrain property at an early stage in proceedings, to prevent the dissipation of property and to freeze bank accounts, following an application to the Court made by or on behalf of the Police, Customs or the Attorney General. Cash can be seized at the border if it is suspected to be associated with drug trafficking (see paragraph 3.11). Aside from these provisions, confiscation procedures follow a criminal conviction. The burden of proof is such that the defendant is then under a duty to rebut the prosecutor's statement of his benefit from crime. Property owned or held by a third party can be confiscated. Between 1992 and 1997, 18 cases, resulting from foreign requests for assistance and involving drug trafficking, resulted in £2.3 million being restrained and/or confiscated, as well as some physical assets whose value is not known. These powers extend to the enforcement of external confiscation orders: on average 6 requests are made per year, and the Isle of Man has received £650,000 in assets shared by other jurisdictions. There are no limits on the Island's ability to share assets with other jurisdictions.
- **Tipping off.** It is an offence, with a maximum sentence of 5 years imprisonment and/or a fine, to prejudice an investigation by tipping off a suspect or third party;
- **International Cooperation.** The Act confers a statutory power for information contained in "all crimes" suspicious transaction reports to be passed to authorities outside the Isle of Man. The information is passed with the permission of the Attorney General at the intelligence-gathering and investigation stages. The provision of all other information and evidence, including that which is to be used at the prosecution stage, is covered by the pre-1998 legislation;
- **Reporting obligations.** Under the earlier Acts covering drugs and terrorism offences, all citizens handling what they suspect to be the proceeds of crime have an obligation to report their suspicions to the Police or Customs. (The obligation is not limited to particular categories of institution or individual). The maximum sentence is 5 years imprisonment. In contrast, the 1998 Act creates an *indirect* obligation to report - the Act criminalises money laundering, but provides an absolute defence where knowledge or suspicion has been promptly reported. The authorities, and indeed the private sector, interpret this as a firm legal reporting obligation. (This issue is discussed in more detail in paragraph 3.16 and 3.17 below). There are exemptions from the obligation to report in cases covered by legal privilege
- **Responsibilities of the Financial Sector.** The Anti-Money Laundering Act

1999 (As Amended), which followed on from the 1998 Act, introduces new obligations on, amongst others, the financial sector to maintain effective anti-money laundering systems. These provisions are discussed in detail in paragraphs 5.2 to 5.4.

- **Bank secrecy and client confidentiality.** There is no general secrecy or confidentiality statute in the Isle of Man. Client confidentiality follows English common law precedent, and is overridden by obligations under the criminal law. The Isle of Man is therefore in compliance with FATF recommendation 2.

The legal position - overall assessment

- 3.5 The legal framework which now exists in the Isle of Man is thorough and comprehensive, and in line with the relevant FATF Recommendations. The Vienna Convention was extended to the Isle of Man from December 1993, and the Council of Europe Convention from May 1995. The nature of the money laundering offences, and the definition of predicates, are drawn widely. The evaluators were particularly impressed with the fact that the obligation to report suspicious transactions is not specific to particular institutions which, coupled with the wide coverage of the Anti-Money Laundering Code, is a particular strength of the Isle of Man's legislative arsenal. The absence of legal constraints on the passage of information internally, and the broad range of crimes on which the Isle of Man authorities can cooperate internationally, are also significant strengths.
- 3.6 The evaluators did have some reservations about some elements of the legal situation in the Isle of Man, specifically:
- the requirement that the Attorney General must approve requests from overseas law enforcement authorities, to release information in respect of intelligence from suspicious transaction reports submitted under the 1998 Act (see paragraph 3.7 to 3.9);
 - loopholes in the power to confiscate cash at the border (see paragraph 3.10 and 3.11);
 - difficulties in reconciling the obligation to report suspicious transactions, and to continue with that transaction to avoid a "tipping off" offence, with obligations to the victims of crime (see paragraph 3.12 and 3.13);
 - the tendency for financial institutions to protect their reputation by refusing business, rather than by reporting their suspicious transactions to the Police or Customs (see paragraph 3.14 and 3.15);
 - in respect of crimes other than drug trafficking and terrorism, the obligation to report suspicious transactions is indirect rather than direct (see paragraph 3.16 and 3.17);
 - more generally, the practice of the Isle of Man authorities in cooperating with other jurisdictions.

considerable delay, legislative developments in the UK, rather than to put in place appropriate measures whether or not they already apply in the UK (see paragraph 3.18 to 3.20).

Cooperation on intelligence matters and the role of the Attorney General

- 3.7 Intelligence from suspicious transaction reports can only be disclosed outside the Island if the provisions of section 17I of the 1998 Act are complied with. The disclosure may be made if the Attorney General has consented to the disclosure and the information is disclosed for the purposes of the prevention or detection of crime, or for criminal the purpose of criminal proceedings. The Attorney General's consent may impose conditions subject to which the disclosure of information is permitted and otherwise restrict the circumstances in which disclosure can be made. This is, in the evaluators' view, an unnecessary constraint on cooperation between law enforcement authorities. It also creates an anomaly, since suspicions of drug and terrorist offences (which aren't covered by this provision) can be passed overseas more liberally than suspicions of other offences. For this reason, financial institutions have to be asked under which offences they are reporting a suspicious transaction.
- 3.8 The evaluators saw no evidence that, in practice, this requirement either delayed or prevented cooperation. Until December 1999 the Attorney General has consented to the disclosure of information to the National Criminal Intelligence Service (NCIS) and other police agencies in the UK and elsewhere, and the authorities report that they have not refused or delayed a request to send intelligence overseas as a result of this provision (save on one occasion, where information was delayed at the request of the receiving authority). On 3 December 1999 (after the evaluation visit) the Attorney General issued a general instruction ("Consent from Attorney General to the Financial Crime Unit of the Police Force of the Isle of Man"), setting out the conditions under which information can be passed overseas without his permission, to a specified list of jurisdictions. The Consent does not remove the Attorney General's ultimate legal responsibility for the process of cooperation between law enforcement authorities. Nevertheless, the evaluators welcome this Consent as a clarification and liberalisation of the constraints under which the Financial Crime Unit must operate. However, this liberalisation does not apply in the case of fiscal offences.
- 3.9 The authorities view is that it is not unreasonable that the Attorney General should be required to give consent in the cases of certain information to certain countries. The Attorney General's powers are subject to judicial review, and he must exercise his discretion in good faith, taking into account only relevant considerations (which might include political considerations). Nevertheless, in the evaluators' view this provision has at least the potential to place the Isle of Man in violation of FATF recommendation 32, which calls for spontaneous or "upon request" cooperation. The evaluators hope that the Isle of Man will remove this provision, and in the meantime will consider further extending the discretion provided in the Consent issued in December 1999. The instructions could be further liberalised by extending the list of jurisdictions it covers. In addition, the evaluators do not consider that separate and more restrictive arrangements can be justified for crimes which are brought into the

Cross-border cash movements

- 3.10 Paragraph 2.9 records the authorities' view that cash placement is not a significant money laundering problem in the Isle of Man. The evaluators accept the representations by the authorities and the financial industry representatives that if a customer arrived at a bank with a large amount of currency it would be regarded as so unusual that it would generally result in notification to the authorities. Nevertheless, monitoring of the movement of cash or negotiable instruments across borders, and powers to prevent those movements where appropriate, are potentially useful weapons in the fight against money laundering. In line with FATF recommendation 22, the evaluators considered whether powers to monitor all cross border cash movements was likely to be necessary, but agreed with the Isle of Man authorities that this would be unlikely in practice to add much to existing powers. Nevertheless, Customs are encouraged to continue to monitor the situation, and to continue to apply regular checks
- 3.11 Both the Isle of Man Customs and Police have the power, under the Drug Trafficking Act 1996, to seize cash which they believe to be instrumental in drug trafficking. The cash can be retained for 48 hours, or for longer with a court order. However a restriction exists in cases where Customs or Police suspect that cash is the proceeds of crime - but cannot tie their suspicions to drug trafficking offences. The effectiveness of this power would therefore be significantly enhanced if it applied on an "all-crimes" basis.

Tipping off and "constructive trust"

- 3.12 Concern was expressed to the evaluators that the requirement not to tip-off a suspected money launderer may conflict with obligations to third parties, under the concept of Constructive Trust. Under English case law, and therefore in the Isle of Man, a financial institution may be held to be a constructive trustee if it holds funds which it suspects rightfully belong to a third party. In some circumstances a financial institution could be held liable for the third party's loss. Some legal experts who spoke to the evaluators believe that the liability may still arise, even where a financial institution was acting on instructions from the Police or Customs to avoid committing a tipping off offence.
- 3.13 The evaluators were unable to assess the extent of this problem in practice. There is at least the perception that financial institutions would be held liable for fulfilling their obligations under the criminal law. This perception might deter financial institutions from enforcing the tipping off provisions, or even from declaring suspicious transactions in the first place. The evaluators recommend that the Isle of Man authorities should cooperate with other jurisdictions where this issue is relevant (particularly the UK, Jersey and Guernsey), to guide the financial sector, and to consider whether new administrative procedures and/or legislation need to be introduced.

Refused business

- 3.14 A number of financial professionals told us that they would turn away business which they suspected might be criminal - for both moral or commercial reasons, and to avoid being

common occurrence in a jurisdiction, like the Isle of Man, where the "off-shore" label might attract people seeking to launder money, in the expectation that such funds will be readily accepted.

- 3.15 While the tendency to refuse suspicious business is in some ways commendable, if refusal is not accompanied by a suspicious transaction report (and it may not need to be if no transaction took place) it provides a missed opportunity to collect intelligence on potential money launderers, who could then be the subject of pro-active investigation by the authorities, in cooperation with other jurisdictions that the failed money launderer is likely to turn to next. It also means the Isle of Man authorities do not receive a clear picture of the money laundering threat. It might also encourage money launderers to believe that their approaches may be rejected, but at least won't be reported. The evaluators therefore recommend that the authorities amend the guidance notes to indicate that best practice requires financial institutions to inform them when turning away business they suspect to be criminal. The intelligence generated by these reports should then be shared, when appropriate, with other jurisdictions. The fear that these transactions will be reported and shared with other jurisdictions, especially with other "off-shore" centres, will help deter professional money launderers from trying to set up different parts of their operations, each in a different jurisdiction, and make it easier for law enforcement to predicate pro-active investigations.

Direct versus indirect reporting obligations

- 3.16 The Drug Trafficking and Terrorism legislation introduced a formal obligation to report suspicious transactions. In contrast, the 1998 Act introduced a more indirect, *de facto* obligation, by providing an absolute defence against prosecution for money laundering in cases where suspicions had been reported to the Police or Customs. There is a significant danger that the reporting obligation in the 1998 Act might be perceived as a lower level of obligation than that which exists for drugs and terrorism offences. This perception could be strengthened by the relevant section of the FSC's guidelines to the financial sector (section 6.04), which say that "*disclosures relating to suspicious transactions other than for drug trafficking and terrorism, such as fraud and fiscal offences (i.e. all crimes disclosures) are not mandatory under the legislation, but a disclosure could be cited as a defence to a money laundering charge. Should licenceholders decide to make a disclosure...*". This sentence is at odds with the view of the authorities that the indirect requirement to report, enshrined in the 1998 Act, is equivalent in practice with the direct requirement under the drugs and terrorism legislation, and amounts to a mandatory requirement. If the interpretation of the law reflected in the FSC's guidance was correct, the Isle of Man would be in partial breach of FATF Recommendation 15. In contrast, the IPA guidelines say that "*...the fact that suspicion has been formed means that there is an obligation to report...*".
- 3.17 Particularly in a jurisdiction where money laundering tends to take place at the layering and integration rather than the placement stage, and therefore where the risk of prosecution for money laundering is small, the indirect obligation is likely to generate fewer reports than a direct obligation. The evaluators therefore recommend that the Isle of Man authorities remove any possible ambiguity by amending the 1998 Act to require

reporting obligation. This might be introduced as part of a more general reform to rationalise the different legal provisions that exist for different types of predicate offence, and to remove once and for all the perception that anti-money laundering systems related to drugs and terrorist offences are somehow distinct from the systems directed at other serious offences.

The Relationship to legislation in the UK

- 3.18 The Evaluation Team was struck by the continual use of the United Kingdom as a reference point, particularly in legal matters, but also in discussion about elements of financial regulation. The authorities signaled a general reluctance to go beyond the legal and regulatory framework that exists in the UK.
- 3.19 While this is understandable, given the Isle of Man's links to the UK and the limited resources it can devote to the drafting of legislation, there is no reason why the Isle of Man's legislation should not go beyond that which applies in the UK. After all, the authorities acknowledge that the Island faces particular risks as a small jurisdiction with limited resources (in absolute terms) to devote to anti-money laundering control, and with a substantial proportion of non-resident business. The time-gap between action in the UK and the response of the Isle of Man Government could potentially be exploited by money launderers. For example, all-crimes legislation in the Isle of Man followed on almost 5 years after the equivalent UK legislation, during which time the Island offered a potential opportunity for money launderers to evade the UK's legislative reach. Notwithstanding this delay, the Isle of Man Government has not taken sufficient opportunity to address deficiencies identified by the UK Government in its own legislative framework (for example, the fact that civil confiscation powers are limited to cash suspected of being the proceeds of drugs, and the confusion created by different legislation covering terrorism, drugs and other crimes), and may not consider doing so until the UK has actually introduced new legislation.
- 3.20 The important exception is the proposed legislation on company service providers (see paragraphs 5.18 to 5.20) which goes beyond the UK approach. The Isle of Man Government's action in this area is therefore particularly commendable, and a sign of its political will to extend the fight against money laundering.

PART IV. LAW ENFORCEMENT

A Financial Intelligence Unit (FIU)

- 4.1 As reported in paragraph 2.14, responsibility for the enforcement of the anti-money laundering legislation lies with the Fraud Squad of the Isle of Man Constabulary and the Isle of Man Customs and Excise. Although there are currently arrangements in place to facilitate informal liaison, the government has (in December 1999, since the evaluation visit) created a Financial Crime Unit. The Unit will act as the Isle of Man's FIU. The authorities intend to use the opportunity afforded by the creation of the new Unit to increase the resources dedicated to the fight against financial crime. The Unit will be headed by a lawyer from the Attorney General's office will be assigned to the unit, and the unit will

also have its own financial analyst. It will take responsibility for fraud and money laundering investigations, receive suspicious transaction reports, lead on confiscation, and deal with requests from overseas law enforcement authorities.

- 4.2 It is not absolutely clear at this stage what role Customs, the FSC and IPA will have within the new Unit. The evaluators strongly recommend that this is clarified. Effective links and cross-fertilisation between the law enforcement and regulatory authorities are a crucial element of an anti-money laundering strategy. The authorities felt that such coordination need not imply co-location of personnel, but in the opinion of the Evaluation Team informal liaison is no substitute for integration and co-location of the relevant staff.

Suspicious transaction reporting

	1995	1996	1997	1998
Total	550	750	1021	1023
<i>From:</i>				
Banks and Building Societies	331	457	646	592
Insurance Companies	182	255	301	311
Company service providers	7	8	23	36
Lawyers	0	0	5	1
Accountants	0	1	2	2
Others	30	29	44	71

Appendix B provides a comparison of these figures with the other UK Crown Dependencies

- 4.3 The overall number of disclosures is encouraging. However, the number of reports from professionals is disappointingly low. The authorities have opened discussions with the relevant professional bodies to address this issue. Having discussed these issues with private sector representatives, the evaluators felt sure that there was significant scope to increase the number of reports from professionals on the Island. Training will be required to effect a paradigm shift in attitudes and culture. In making these observations, the evaluators note that such a cultural change will also be necessary in all those jurisdictions seeking to improve anti-money laundering compliance amongst professionals.
- 4.4 The rise in the number of reports up to 1997 is interpreted by the authorities as a sign of increased awareness by the financial sector - rather than an increase in the number of suspicious transactions passing through the Island. It is surprising that the number of disclosures hasn't risen significantly as a result of the new obligations under the 1998 Act. The authorities considered that this indicates a high degree of compliance under the previous drugs and terrorism legislation, rather than a sign that understanding of the new legislation is poor. They also suggest that, as a result of awareness training, the finance industry is examining its reports more closely.

More analysis is required to confirm this conclusion.

- 4.5 The Fraud Squad acknowledges that the provision of more effective feedback to the financial sector could be helpful in encouraging compliance. Although feedback is provided in very general terms, on specific investigations the Isle of Man authorities often do not themselves know the extent to which the intelligence they provide has proved helpful to other jurisdictions. The authorities need to do more to follow up the reports they send to the UK authorities in particular, not least to assess whether further action is required in the Isle of Man. This includes cases where the UK authorities have taken no action, but where the Island's authorities might be able to do so. It would therefore be prudent for the Island's authorities to seek more feedback from other jurisdictions, and where possible to inform the financial sector of the positive impact their intelligence has had.
- 4.6 To date, the Fraud Squad has not conducted meaningful analysis of the cumulative intelligence available from the reports submitted over the last 5 years. The Evaluation Team were surprised that such a unique opportunity was being missed here, and considered the lack of analysis to be a material weakness. Analysis of the trends in the data would add significantly to the knowledge-base of the authorities. For example, are the suspicious transaction reports coming from a limited pool of institutions: is compliance broadly based? What activities are triggering the reports? This type of analysis will place the Isle of Man in a stronger position to develop new anti-money laundering counter measures. It is also important to analyse the reasons for low levels of disclosures by some institutions or professionals, and to pass this valuable information to the regulator. Not only would this assist the regulators to target their compliance effort, it may also provide evidence for taking regulatory or criminal proceedings against some institutions. It could also provide valuable intelligence to support a more pro-active enforcement strategy (discussed in more detail in paragraph 4.14). The Island's authorities agree that analysis of the reports would be helpful, but argued that the work should be deferred until after the FIU was in place.

International exchange of information

- 4.7 The Isle of Man authorities are proud of their record of cooperation with overseas anti-money laundering authorities. They have contributed significantly to a number of successful international enquiries. The authorities also have good links with other English speaking FIUs. They acknowledge the need to develop much better links with European FIUs, where informal contact and formal requests for assistance are surprisingly rare (perhaps because overseas authorities underestimate the extent of cooperation they can expect from the Isle of Man).
- 4.8 The authorities do need a clearer and more open policy on the spontaneous passage of relevant intelligence from suspicious transaction reports to other jurisdictions. Intelligence from these reports is routinely sent to the UK's National Criminal Intelligence Service (NCIS), although with restrictions on the on-ward transmission of that intelligence to other jurisdictions. The Evaluation Team recommend that, as a matter of priority, transmission of relevant intelligence to other jurisdictions should be encouraged.

achieved either by allowing the reports passed to NCIS to be passed on to other jurisdictions at the discretion of NCIS, or through the development of direct contacts between the FIU in the Isle of Man and other jurisdictions, or through both mechanisms. Talks have been held already with the UK, US and Canada. As a matter of priority, the authorities should develop more Memoranda of Understanding with their key contacts in those and other jurisdictions, and especially to share information with the Channel Islands.

- 4.9 The Isle of Man has recently become a member of the Egmont Group, but resource constraints have so far prevented them from participating in meetings. The Evaluation Team expressed the hope that the new Financial Investigation Unit would be sufficiently resourced to allow effective participation by the Isle of Man in the Egmont process. Since the evaluation visit, the authorities report that the budget has been increased to enable them to participate fully.

Money laundering investigations and prosecutions

- 4.10 The authorities estimate that 1 in 5 suspicious transaction reports contains evidence which is relevant to a money laundering enquiry, and deserves further investigation. A very high proportion relate to the United Kingdom, and fraud enquiries constitute a significant proportion. An assessment must be made as to whether the enquiry is likely to fall within the remit of the Customs or of the Police. The creation of the Financial Crime Unit, with enhanced liaison between the Unit and Customs and Excise should help to make this process more efficient, and reduce the likelihood of enquiries falling through the gaps.
- 4.11 The Isle of Man authorities were involved in 52 money laundering investigations in 1997 and 76 in 1998, including a number of investigations into Value Added Tax and Excise Frauds where funds were suspected to have been layered through the Isle of Man.

Table 3: Money laundering investigations conducted by the Isle of Man authorities

	Police	Customs
1995	21	10
1996	30	10
1997	35	17
1998	54	22

- 4.12 But, while the Isle of Man's record in cooperating with investigations initiated overseas has been good, there has been only one prosecution for money laundering initiated in the Island (which was prosecuted under the Drug Trafficking legislation). It is also very rare for the Isle of Man authorities to make external requests for assistance in cases which they have initiated (there were only 7 such cases in the 1997 and 1998, where in each case the predicate offences had occurred in the Isle of Man). The authorities offer a number of

explanations:

- the Isle of Man is a small, low crime jurisdiction, and the need for investigations where the predicate offence (as opposed to the money laundering itself) occurred on the Island is small;
- the "all crimes" legislation is relatively new and, in the case of drug offences, it is considered preferable to mount prosecutions against the predicate offences;
- law enforcement resources have been too thinly stretched. The authorities acknowledge that resources have been overtaken by the growth of suspicious transaction reports, and the demands of the new legislation;
- it is difficult to initiate prosecutions in jurisdictions characterised by the layering stage of money laundering.

4.13 This final assumption is an important factor determining the Isle of Man's anti-money laundering strategy, which tends to be reactive rather than proactive. The Isle of Man authorities see their primary role in respect of money laundering deterrence as cooperation with overseas jurisdictions - a role which they fulfill effectively. In most cases they assume that it is the role of the jurisdiction where the predicate offence took place, or where initial placement took place, to initiate enquiries. This assumption is clearly realistic to some extent; but, in the view of the Evaluation Team, it underestimates the role that pro-active enforcement could play in the context of the Isle of Man.

4.14 The introduction of new legislation, and the additional resources which the authorities intend to dedicate to the investigation of financial crime, provides the authorities with an excellent opportunity to develop a new, pro-active strategy to investigate and prosecute money laundering in the Isle of Man. To make this strategy effective, the authorities will need to ensure that :

- the senior officials responsible for anti-money laundering strategies (the Attorney General, Chief Secretary and Chief Executive of the FSC) drive the strategy effectively;
- a joint initiative is agreed between the Financial Crime Unit, Customs and the two regulators, and that regulatory and law enforcement powers are effectively exploited towards common targets and objectives;
- effective analysis of intelligence from suspicious transaction reports is undertaken, and is shared with Customs and the financial regulators, so that mechanisms can be put in place to target those whose volume of reporting is considered low, and to develop new regulations and countermeasures;
- the use of undercover law enforcement operations and pro-active policing techniques are actively considered;

- pro-active cooperation with overseas authorities, and through the Egmont Group, is established and extended;
- an adequate level of resources, and access to professional expertise (in particular, legal and forensic accountancy skills) is available;
- regular monitoring of success, against performance indicators is undertaken.

4.15 Many of the challenges facing the authorities in the Isle of Man are being confronted also by the authorities in Guernsey and Jersey. In promoting this strategy, the Evaluation Team recommend that the Isle of Man's authorities - the Attorney General, the Police/FIU, Customs and the two regulators - meet their opposite numbers from the two Channel Islands on a regular basis to discuss their coordinated strategy against money laundering. This "Islands' Anti-Money Laundering Forum", which might meet around three times a year, could form a valuable framework for the development of a pro-active and coordinated enforcement strategy in all three islands.

Part V. Financial Regulation

5.1 This section of the Report considers financial regulatory issues, including the 1998 Code (as amended) and guidelines, the efforts of the authorities to ensure the Code and guidelines are complied with, and the Isle of Man's proposals to improve anti-money laundering compliance by the company and trust sectors. The regulatory standards are defined by:

- The Anti-Money Laundering Code 1998 (the 1998 Code), a piece of secondary legislation which followed on from the 1998 Act;
- The Anti-Money Laundering (Amendment) Code 1999, a further piece of secondary legislation which amends the 1998 Code, and came into operation on the 1st December 1999;
- Industry Guidelines drafted (separately) by the FSC and IPA. Although this guidance is not legally binding, compliance with the Guidelines is a strong indication of compliance with current best practice

The 1998 Code

5.2 The Code applies to a very wide range of financial businesses; including (inter alia) banks, building societies, investment businesses, insurance companies, bureaux de change, bookmakers and casinos, money transmission and cheque cashing services, lawyers, registered legal practitioners and accountants, company service providers and trust service providers.

5.3 The Evaluation Team were particularly impressed by the scope of the responsibilities imposed by the 1998 Code and Act; particularly the broad obligations placed upon lawyers, which overrode their ethical obligations to their clients.

inclusion of company and trust service providers takes the scope of the Code beyond the requirements of the EU Money Laundering Directive.

5.4 The Code applies to new accounts, and covers:

- **verification of identity.** The Code requires relevant businesses to establish and maintain procedures to collect satisfactory evidence of identity, in respect of all on-going relationships, and one-off or linked transactions over 15,000 Euros (or over 3000 Euros where such transactions are related to the business of a bookmaker or casino). Particular guidance is provided in respect of non-face-to-face verification. The exception to these arrangements ("eligible introducers") is discussed in more detail in paragraphs 5.21 to 5.25. The 1999 Amendments to the Code made some changes to the coverage of the verification requirements, which are covered in more detail below.
- **retention, format and retrieval of records.** Relevant businesses are required to keep records of transactions and customer identification for at least 5 years from the point at which (a) the business relationship was ended or (b) a one-off or linked transaction was completed or (c) the last transaction was carried out or (d) for as long as the Police or Customs require when a matter is under investigation. In respect of (a), the record keeping requirements apply to a longer period of time than that specified in Recommendation 12.
- **recognition and reporting of suspicious transactions.** All relevant businesses are required to establish a reporting chain to a Money Laundering Reporting Officer (MLRO). The MLRO is responsible for submitting reports to the Police. The regulators only see specific reports if the financial institution sends them a copy. In paragraph 4.6 and 4.14 of this report the Evaluation Team recommend that the regulators increase their role in analysing the intelligence provided through suspicious transaction reports.
- **staff training.** All relevant businesses are required to provide training for all appropriate employees.

The 1999 Amendments to the Code

5.5 Amendments to the Code were introduced after the evaluation visit, on 1st December 1999. The definition of "regulated person" has been extended to include building societies authorised to carry on business in the Island. There are also important changes affecting the obligation to establish identity. The 1998 Code applied this obligation to new business relationships, and also to business relationships established before the Code came into effect. This provision attracted criticism from the financial sector, who argued it was out of line with the requirements of other jurisdictions, and imposed an unreasonable administrative burden. Consequently, the amended Code exempts business relationships formed before the 1st December 1998 from the requirement to establish identity. There is now no legal obligation to establish identity in business relationships which commenced before that date.

all their accounts to ensure that reasonable verification has been established.

- 5.6 The evaluators expressed regret that a provision which, at the time of the evaluation visit, they regarded as a strength of the Isle of Man's system has been amended in this way. They recommend that customer identity is established for all current business relationships.

The Financial Supervision Commission (FSC)

- 5.7 The FSC is responsible for regulating, inter alia, the Island's banks, building societies and investment schemes. In 2000 the Company Registry will also fall within the scope of the FSC's responsibility. It is also planned to give FSC responsibility for the licensing and supervision of company formation agents.
- 5.8 At the time of the evaluation visit, the FSC was consulting the financial industry on a revised version of their anti-money laundering Guidelines, which incorporates the provisions of the new Code. These Guidelines are very thorough and comprehensive, and amount to an impressive survey of the steps that institutions should take to comply with the law. They cover each of the items set out in paragraph 5.4, providing additional details and advice. The notes include a section on countries and territories which need to be regarded with particular care. This is used to alert financial institutions to regimes highlighted by either the UK or FATF under FATF Recommendation 21. The new draft FSC Guidelines also contain new sections setting out money laundering typologies, including an assessment of the risks from internet commerce. The notes also include guidance on "eligible introducers", a subject covered in paragraphs 5.21 to 5.25 of this report.
- 5.9 The FSC's regulated institutions are overseen by specialist individual supervisors. There is no dedicated anti-money laundering unit. Licensees are subject to a vetting process, on application or where a change of ownership (amounting to 15 per cent of share capital) takes place. Once licences have been awarded, supervision consists of on-going prudential monitoring and on-site visits. The on-site visits are of three types (a) an annual review visit, linked to the renewal of licences (b) focused supervisory visits, looking in detail at particular aspects and (c) full supervisory visits, used in particular to focus on institutions considered to be at particular risk. Recently the focused visits (b) have included a programme looking in detail at Know Your Customer and new client procedures. Anti-money laundering procedures also play an important role in (a) and (c). The FSC also employ risk assessment techniques in which money laundering is a component part. The risk assessment determines the frequency of on-site inspections.
- 5.10 The FSC has a wide range of powers and sanctions, which it has used regularly (although not as yet explicitly for anti-money laundering non-compliance). The FSC can wind up companies in the public interest and declare individuals unfit. Licences can be suspended or revoked, and specific "directions" can be placed upon licensees.

The Insurance and Pensions Authority (IPA)

- 5.11 The IPA is responsible for the regulation of the Isle of Man's significant insurance sector - identified in paragraph 2.11 as a potential target for money launderers. The IPA has produced anti-money laundering Guidelines for the insurance sector. As for the FSC Guidelines, compliance with the IPA's Guidelines can be used as evidence in Court that a financial institution has the systems required by the Anti-Money Laundering Code 1999. Although the IPA Guidelines cover the fundamentals, they are neither as comprehensive nor as up-to-date as those issued by the FSC. For example, they do not provide as detailed advice on customer identity requirements, particularly where there is no face-to-face contact or where introduced business is involved, nor do they refer to the Isle of Man Disclosure Form.
- 5.12 In contrast to the FSC, the IPA does not generally conduct compliance visits. Instead IPA focuses on "off-site" regulation and assessments of "fitness and properness", in keeping with its focus on prudential supervision. In order to check compliance with the anti-money laundering Guidelines, the IPA relies exclusively on the endorsement of anti-money laundering systems by external auditors. Under the Insurance Regulations 1986, directors of regulated firms are required to make a declaration of compliance with the IPA's anti-money laundering Guidelines, and the external auditors are required to certify that, to the best of their knowledge, the declaration is accurate.
- 5.13 The evaluators had some concerns about this. They felt that the system the IPA has in place to check compliance with the Code and Guidelines was overly reliant on compliance-checking by external auditors, and needs to be supplemented by positive action by the IPA. The evaluators see no reason why the anti-money laundering regulatory procedures applied to the insurance sector should be different than those which apply, for example, to banks and building societies - not least because of the importance of insurance to the Island's economy.
- 5.14 The evaluators' general conclusion is that the IPA needs to be more "hands on" in ensuring compliance with anti-money laundering standards - in keeping with the risks arising in respect of the insurance sector. Further consideration needs to be given to the IPA's anti-money laundering strategy, to ensure effective compliance with FATF recommendation 26 in respect of insurance business. The Evaluation Team considered it important to ensure and enforce a common set of comprehensive anti-money laundering standards throughout the Isle of Man's financial sector. The evaluators were not in a position to judge whether this conclusion is unique to the anti-money laundering role. The Isle of Man considered whether to merge the IPA and FSC and concluded that they should remain separate.

Compliance

- 5.15 The authorities consider that, in general, financial institution's compliance with anti-money laundering standards is good but variable; an assessment that was confirmed by the number and pattern of suspicious transaction reports. They describe compliance by the banks as "excellent". Financial institutions with parents in large financial centres tend to have a strong compliance culture. The risk from small investment business licence holders and fiduciaries is much greater. The overall level of suspicious transaction reports from

insurance businesses is very good, but the IPA has not exploited their value by conducting analysis of the cumulative intelligence. The IPA needs to look behind those figures to assess any variation in compliance between individual institutions. When this issue was raised by the evaluators, the IPA agreed it would be better to analyse the reports in future, but gave no indication that they intended to review the existing stock.

- 5.16 The penalty for contravention of the Code is six months imprisonment or a fine not exceeding £5,000. Although regulatory sanctions might also apply, neither FSC nor IPA has the power to levy fines. The Evaluation Team considered that, in cases where a custodial sentence for breaches of the Code is unlikely, the maximum fine was set at too low a level to act as a deterrent. It is recommended that the authorities consider raising the penalties for non-compliance with the preventative measures set out in the Code, and with the FSC's regulatory standards. This might be achieved through enhanced criminal sanctions for non-compliance with the Code, and through the introduction of a fines regime for non-criminal regulatory breaches.

Company and Trust Service Providers

- 5.17 The Isle of Man's corporate service providers are included amongst the institutions covered by the Anti-Money Laundering Code. At the time of the evaluation visit, their compliance with the Code was not supervised. However, the Isle of Man intend to introduce new legislation (the Corporate Service Providers Bill) to bring this sector within the responsibility of the FSC, and to introduce a new licensing regime. The intention is to implement the new system during 2000, and to subject this sector to the full supervisory regime described in paragraph 5.9 and 5.10. The authorities believe they are the first jurisdiction - onshore or offshore - to introduce such a regime, and contrast this with other jurisdictions where company service providers remain unregulated, including some where the register of companies is secret. The evaluators strongly endorse the approach the Isle of Man has taken with respect to this key sector (although see paragraphs 5.20 to 5.24 on "eligible introducers"). They encourage the authorities to enact and enforce this legislation as a matter of priority, and thereby set the model which other jurisdictions should follow.

- 5.18 The new legislation is presented by the authorities as a more effective mechanism for ensuring compliance by the company sector than the alternative model, in which all private companies would be required to register their beneficial ownership on either a public register or with the authorities. Although the evaluators regard the public disclosure of beneficial ownership as the ideal mechanism, the authorities are right to focus initially on the role played by professionals and intermediaries. Nevertheless, the Isle of Man authorities should keep the position under review and, should the regime prove inadequate in the light of the risks of abuse, they should consider imposing an obligation on the companies themselves to report beneficial ownership. In the meantime, they ought to seriously consider introducing the system of company vetting employed in the Channel Islands.

to those providing similar services in respect of trusts, but will only do so when the corporate service provider regime is in place and proven. The Evaluation Team found this delay surprising, given the linkages between the two sectors, and the similarity of the anti-money laundering issues involved. The evaluators encouraged the authorities to look in detail at this sector, perhaps in consultation with the Channel Islands and other jurisdictions where trusts also play an important role, to consider additional measures which may have to be taken.

Eligible Introducers

- 5.20 The Isle of Man employ a concept referred to as "eligible introducers", to facilitate arrangements for financial business introduced by certain intermediaries. The rules apply, for example, where an accountant is seeking to open a bank account on behalf of his client, or an overseas bank is providing a reference for one of its customers to purchase investment products in the Isle of Man. In some circumstances, banks may not know the beneficial owner of the funds they hold, while still complying with the letter of the law in the Isle of Man. The evaluators considered this system in some depth, and particularly the implications for FATF Recommendation 11.
- 5.21 Under the FSC's Guidelines, eligible introducers can be:
- financial institutions regulated by the FSC and subject to the 1998 Code. Once company service providers are brought within the regulatory umbrella of the FSC, this provision will extend to them;
 - authorised financial institutions in FATF member countries, and (since the 1999 Amendments to the 1998 Code) Jersey and Guernsey;
 - an advocate or accountant, where the licenceholder is satisfied that the relevant professional body is enforcing standards equivalent to those in the 1998 Code;
- 5.22 A copy of the FSC guidelines on eligible introducers is attached as appendix E to this report. The IPA guidelines are similar, though less comprehensive and detailed. With both the FSC and IPA Guidelines, where an intermediary falls within the definition of "eligible introducers", financial institutions can delegate to them the responsibility to hold information on beneficial ownership of the funds, and the documentation collected in the course of verifying that identity. In return, the introducer must sign a certificate declaring that they "will supply forthwith upon request satisfactory evidence of the identity of this applicant for business".
- 5.23 The evaluators agreed that, under certain very limited prescribed circumstances, some elements of the responsibility to verify identity could be entrusted to regulated intermediaries - provided that financial institutions were confident that they held in their possession sufficient information to know their customer, and to judge whether the account transactions are suspicious. However, the evaluators were concerned about a number of features of the system:

- the evaluators believe, the system would leave banks with insufficient information to discharge their responsibilities. Not only do banks need to satisfy the “know your customer” obligations on an on-going basis, they also need sufficient information about the beneficial owner of the funds, and that person’s business, to allow the bank to make a proper assessment of whether or not a transaction is suspicious. If this information is not held by the bank, how can the bank satisfy that obligation?
- the list of “eligible introducers” is drawn too widely. For example, it includes UK lawyers and accountants, despite the fact that they are not generally subject to statutory anti-money laundering regulation. Furthermore, when the licensing regime is introduced, Isle of Man corporate service providers will be able to act as eligible introducers - notwithstanding the reservations that the Island’s authorities themselves have about some elements within this industry. The inclusion of corporate service providers as eligible introducers is a potential weakening of the system, which detracts from the benefits of bringing this sector within the regulatory umbrella;
- the status of eligible introducer does not depend on the degree of “distance” between the introducer and the financial institution. There might be a stronger case for a greater reliance on the introducer where they are in regular contact with the financial institution, and where the introducer is aware of the financial transactions being conducted. But the Isle of Man arrangements apply equally where an introducer merely opens an account, and has no further dealing with the financial institution handling the transactions;
- the FSC’s guidelines state, when dealing with corporate clients, “*The Commission believes that it is best practice for licence holders to seek to establish and verify the identity of beneficial owners of companies*”. In the evaluators’ view, to do so should be mandatory.

5.24 Recommendation 11 was not drafted explicitly to cover circumstances where intermediaries were themselves under statutory regulation; as will be the case with at least some of those intermediaries which fall under the definition of “eligible introducers”. Nevertheless, the evaluators concluded that the Guidelines leave Isle of Man financial institutions in breach of FATF Recommendation 11, and the relevant interpretative notes. They urge the authorities to tighten the Guidelines on this issue, and to impose upon financial institutions an over-riding obligation to know the beneficial owner of funds, and to be in a position to quickly and properly assess the suspicion or otherwise of transactions that they process.

Regulatory cooperation

5.25 Both the FSC and IPA have information gateways which allow them to cooperate and share information with overseas regulators. Significantly, there are no legal constraints on cooperation between law enforcement and regulatory authorities. As a matter of

international requests for assistance.

Anti-money laundering training

- 5.26 In general, the level of understanding about the threat posed by criminal money flows is high in the banking sector. The Evaluation Team found evidence of a strong "compliance culture", and the authorities place a high priority on training. For example, the FSC is developing a new CD-ROM based training package, which allows employers to monitor the amount of anti-money laundering training that their staff have undertaken - and the level of individuals' understanding.
- 5.27 The Customs, FSC and the Police organise their own training sessions. Although there are also joint training initiatives, the divided responsibilities for anti-money laundering training create at least the potential for inefficiency and overlap, although in a small Island this may be less of a danger. Nevertheless, the Evaluation Team recommend that the authorities consider the scope for further coordination of their training effort. Awareness amongst other groups, particularly lawyers, accountants and company and trust service providers, may be at a lower level, and it is these groups that the authorities will need to target in future.

Part VI. Summary

- 6.1 The Isle of Man has a robust arsenal of legislation, regulations and administrative practices to counter money laundering. Perhaps more importantly, the authorities clearly demonstrate the political will to ensure that their off-shore financial institutions and the associated professionals maximise their defences against money laundering, and cooperate effectively in international investigations into criminal funds. The standards set in the Isle of Man are close to complete adherence with the FATF's 40 Recommendations. There are a few areas where the appropriate changes would allow these standards to be met unambiguously.
- 6.2 The legislation to criminalise money laundering on an all-crimes basis is still relatively new, and to some extent the Isle of Man is a jurisdiction in transition. The Isle of Man is now largely in line with the legal system that exists in the United Kingdom. The provisions meet, and in some areas exceed, the relevant international standards. The money laundering offences are broad, and cover all indictable offences. The requirement to report suspicious transactions applies universally, and not simply to specified sectors. The lack of legal constraints on domestic and international cooperation is particularly notable, as is the broad range of powers to confiscate criminal assets, and the powers to investigate serious or complex fraud. This report recommends removal of the provision in the new all-crimes legislation which requires the Attorney General to authorise the passage of financial intelligence overseas. The Isle of Man should move to a position in which relevant information is passed overseas on a routine basis. The all-crimes legislation includes an obligation to report suspicious transactions which appears to set a lower level of obligation than the longer-standing legislation related to drugs and terrorism. This report recommends a rationalisation of these provisions, to impose an unambiguous mandatory reporting obligation on all persons doing a listed activity.

- 6.3 The Isle of Man authorities have a good record of cooperation with overseas requests for assistance, on both regulatory and criminal matters, and the new legislation allows this cooperation to be enhanced. They have been less successful at pro-active investigation of money laundering, and examples where investigations have been initiated on the Island are rare. The creation of a new financial crime unit, with new resources, provides an excellent opportunity for the Isle of Man authorities to implement a new, pro-active enforcement strategy - bringing together the expertise of the police, customs and regulators. This strategy would involve more effective analysis of the financial intelligence available to the authorities, and close cooperation with the Channel Islands. The authorities need to provide sufficient resources to ensure this strategy can be implemented effectively. The law enforcement authorities should also be more willing spontaneously to send relevant financial intelligence overseas, and should develop a wider range of international contacts. They should sign more Memoranda of Understanding with their most important contacts. Investigative powers are comprehensive, although the Isle of Man should consider enhancing its powers to confiscate suspicious cash imports into the jurisdiction.
- 6.4 The system of financial regulation is comprehensive and effective. The Anti-Money Laundering Code sets a high standard, and applies that standard to a very wide range of financial institutions and professionals. The money laundering guidance notes provided by the Financial Supervision Commission (FSC) give clear advice to the financial sector on the risks they face from money launderers. Regulation of the insurance sector is the responsibility of the Insurance and Pension Authority. Their guidelines on money laundering are less comprehensive than those issued by the FSC. Their approach to supervision does not involve them directly in routine assessment of anti-money laundering compliance; they rely instead on the endorsement of anti-money laundering standards by external auditors. This report proposes that a comprehensive and consistent set of anti-money laundering procedures is enforced throughout the Isle of Man's financial sector. The system would be even more robust if the regulators were given the power to levy administrative fines for non-compliance.
- 6.5 The financial sector in the Isle of Man demonstrates a good compliance culture. The number of suspicious transaction reports made by the financial sector is relatively high, although there are areas - particularly amongst professionals - where compliance needs to be significantly improved. The authorities should provide more feedback on the results generated by suspicious transaction reports, and should better coordinate their efforts to raise awareness of money laundering issues.
- 6.6 The Isle of Man authorities propose to tighten up regulation in the company sector, which they regard as the most vulnerable to money laundering. This report strongly endorses the authorities' plans to regulate, license and supervise company formation agents. This measure places the Isle of Man at the forefront of international efforts to prevent the abuse of company structures for criminal purposes. To ensure this legislation succeeds in reducing the extent to which company service providers and other financial intermediaries can be used for the purpose of money laundering, the authorities need to remove an important loop-hole in the system. Under the "eligible introducers" arrangements, where the owner is represented by a regulated intermediary, a company can be formed in the Isle of Man without the need for a local presence. This report proposes that the authorities should require the introducer to be a regulated intermediary, and to be a resident of the Isle of Man. This would ensure that the introducer is subject to the same regulatory requirements as the company formation agent, and would ensure that the introducer is able to provide the same level of service as the company formation agent. This would also ensure that the introducer is able to provide the same level of service as the company formation agent, and would ensure that the introducer is able to provide the same level of service as the company formation agent.

lawyer or accountant - a financial institution need not know the beneficial owner of funds. In the view of the evaluators, this represents a potentially serious gap in the system, and the report proposes that the authorities set out an over-riding obligation on all financial institutions in the Isle of Man to know the beneficial owner of the funds with which they deal.

- 6.7 The evaluators consider that the Isle of Man authorities have constructed a comprehensive anti-money laundering system, and that the adoption of the proposals contained in this report will ensure it complies with the best international standards. Finally, the evaluation team would like to repeat their thanks to the authorities in the Isle of Man for the constructive way in which they participated in the mutual evaluation process.