
SECTION 2

LICENSING OF FUND MANAGERS, FUND ADMINISTRATORS AND THIRD PARTY FUND ADMINISTRATORS

2.1 [INVESTMENT BUSINESS ACTS 1991- 1993](#)

[The Investment Business Act 1991](#), as amended by the Investment Business (Amendment) Act 1993 ("the IBA") is the statutory basis for regulating investment businesses operating in or from the Isle of Man. The IBA, which became fully operational on 31st March 1992, repealed and replaced section 7 of the Banking Act 1975, which was previously the statutory basis for regulating investment businesses.

[Section 1\(2\)](#) of the IBA states that "the Treasury may by Order prescribe activities which shall constitute investment business ...". Accordingly, the Investment Business Order 2004, at [Part 1](#) of Schedule 1, ("the IB Order") (see [Appendix A3](#)) prescribes and defines the activities which constitute investment business.

The activities which constitute investment business are as follows:

1. dealing in investments, either as principal (but not private investment companies) or as agent;
2. arranging deals in investments on behalf of other people;
3. giving investment advice;
4. managing investments; and
5. acting as manager or trustee of any collective investment scheme, whether or not such scheme is established in the Island, or providing any of the services which the operator of such a scheme would normally undertake.

This should be read in conjunction with paragraph 19 of Schedule 1 of the Order which states: -

"Collective Investment Schemes

20(1) The trustee of:-

- a. any collective investment scheme which is exempted under [Section 11\(7\) to \(10\)](#) of the Financial Supervision Act 1988 ("exempt international collective investment scheme"); or
- b. any collective investment scheme which is managed in and subject generally to the law of a country or territory outside the Isle of Man instead of to the law of the Island

shall not be treated as carrying on investment business as respects any business he may carry on by virtue of that position.

2. A person who acts as manager of no more than one exempt international collective investment scheme ("an excluded scheme manager") should not be treated as carrying on investment business as respects any business he may carry on by virtue of that position.
3. The provision of registration services or accountancy services to any collective investment scheme which is exempt under [Section 11\(7\) to \(10\)](#) of the Financial Supervision Act 1988 shall be deemed not to constitute services within the contemplation of paragraph 5.
4. The provision of administrative services to excluded scheme managers shall be deemed not to constitute services within the contemplation of paragraph 5."

[Section 2](#) of the IBA states that:

"Any person who carries on, or holds himself out as carrying on, in or from the island, investment business -

- a. in respect of which no investment business licence is in force; or
- b. if such a licence is in force, other than in accordance with the conditions, if any, of the licence, shall be guilty of an offence".

Where an investment business licence is issued, a series of regulatory codes will apply to that licenceholder (see [para 2.8](#)).

2.2 LICENSING REQUIREMENT

As can be seen, except where a manager of a professional or experienced investor fund is situated in the Isle of Man and that manager has delegated the majority of its activities to a fund administrator (ie an "exempt person" in accordance with the [Investment Business \(Exemption\) \(Fund Managers\) Regulations 1999](#)), managers of authorised and international collective investment schemes as well as fund administrators and third party fund administrators are carrying on investment business by virtue of paragraph 5 of [Part 1 of Schedule 1](#) of the IB Order. Consequently, they are required to hold an investment business licence issued by the Commission under section 3 of the IBA. Furthermore, the provisions of [sections 3 and 11](#) of the Financial Supervision Act 1988 ("the FSA") require that the managers of authorised and international collective investment schemes must hold an investment business licence.

It should be noted that, where collective investment schemes are constituted as open-ended investment companies, the fund company itself does not require an investment business licence as it is exempted from requiring a licence by virtue of the Investment Business (Exemption) (Miscellaneous) Regulations 1998.

2.3 GENERAL LICENSING POLICY

The General Licensing Policy for those seeking a Banking, Investment Business or Fiduciary Services Licence (see [Appendix M1](#)) sets out the general criteria the Commission will normally apply in assessing the fitness and propriety of licence applicants and of individuals with key roles and/or significant influence in respect of those businesses. The specific requirements and considerations applicable to investment business are summarised in tables A to E in Appendix 1 to the licensing policy.

The licensing policy applies to applicants for investment business licences, which are required to meet the "fit and proper" criteria, and, on an on-going basis, to licenceholders which must continue to be "fit and proper". (See also [section 2.8](#) below.)

2.3.1 The Commission's Fit and Proper Test

The Investment Business Act 1991, as amended by the Investment Business (Amendment) Act 1993 ("IBA") requires that: -

1. an applicant for an investment business licence; and
2. any controller, director or manager (including the company secretary and compliance officer) of the applicant

must be "fit and proper persons".

The fitness and propriety criteria apply both in relation to the initial application for an investment business licence and thereafter to the licenceholder on an ongoing basis. The Commission's General Licensing Policy for those seeking a Banking, Investment Business or Fiduciary Services Licence sets out the criteria it will normally apply in assessing fitness and propriety.

2.4 AUTHORISED SCHEME MANAGERS - Licensing and Regulation

2.4.1 General

Before applying for an investment business licence, the manager of an authorised scheme must first satisfy the requirements of section 3 of the FSA. That is the manager must be independent of the authorised scheme's trustee, it must also be a body corporate having a place of business in the Island, and must not be prohibited from acting as a manager of an authorised scheme under any enactment. The Commission's interpretation of the independence requirement for managers and trustees of authorised schemes is that they must be completely separate entities both in terms of ownership and operation.

A manager of authorised schemes is normally licensed by the Commission to manage specifically named schemes. Consequently, a manager of authorised schemes may not undertake the management of additional schemes unless the Commission grants its approval by extending the manager's licence to cover those additional activities.

It is important that authorised scheme managers carefully note the restriction on their activities imposed under section 8 of the FSA. Essentially, [section 8](#) restricts the manager of an authorised scheme from engaging in any activity other than that of acting as a manager of collective investment schemes; although additional activities may be undertaken provided they are agreed in writing by the Commission.

2.4.2 The Collective Investment Schemes Compensation Scheme ("Compensation Scheme")

Managers of authorised schemes are also required to be party to the compensation arrangements for authorised schemes provided for by the [Authorised Collective Investment Schemes \(Compensation\) Regulations 1988](#) ("the Compensation Regulations" see [Appendix B3](#)). [Regulation 13](#) of the Compensation Regulations requires every manager of an authorised scheme during the financial year of the compensation scheme to submit to the Commission a declaration in writing of the annual value of the property of every authorised scheme of which it was the manager. The written declarations must be submitted each year to the Commission within four months of 31 March, which is the Compensation Scheme's year-end. The annual value of the property of each authorised scheme must be calculated in accordance with the formula laid down in [regulation 13](#) of the Compensation Regulations. The Commission would expect managers to take account of their potential liability to the Compensation Scheme as a "contingent liability" for accounting purposes. Each manager's liability is calculated in accordance with the formula contained in [regulation 16](#) of the Compensation Regulations, based on the value of the funds stated in the annual declaration.

2.5 INTERNATIONAL (EXCLUDING PROFESSIONAL AND EXPERIENCED INVESTOR & OVERSEAS FUNDS) SCHEME MANAGERS - Licensing and Regulation

The only requirement imposed under [section 11](#) of the FSA regarding managers of international collective investment schemes, apart from the requirement to hold an investment business licence, is that they must be a different person to the trustee of the international collective investment scheme. The requirement to be different persons rather than independent persons, as is the case with managers and trustees of authorised schemes, means that the manager and trustee of an international collective investment scheme may be separate entities within the same corporate structure. However, the Commission recognises that it is desirable in the interest of investors that there should be a clear separation of functions between the manager and trustee where they are companies within the same group, so as to ensure that the interests of participants or potential participants in an international collective investment scheme are not compromised. To this end, the Commission would expect certain requirements to be satisfied before licensing a manager who is associated with the trustee of the international collective investment scheme which it manages. The Commission's requirements in this regard are contained in the Guidance Notes for Managers and Trustees of International Collective Investment Schemes (see [Appendix C4](#)).

2.5.1

"Real Presence"

Whilst the Commission requires a manager of an international collective investment scheme to be an Isle of Man body corporate, it need not maintain a "real presence" in the Island provided that its business is administered by a licensed third party fund administrator (see [paragraph 2.6](#)). The managers of international collective investment and authorised schemes whose businesses are administered by third party fund administrators will still be required to hold an investment business licence, and therefore, to satisfy the Commission's normal licensing criteria in respect of fitness and propriety (see [licensing policy](#)).

2.5.2 Licensing

A manager of international collective investment schemes is normally licensed by the Commission to manage specifically named schemes. Consequently, a manager of international collective investment schemes may not undertake the management of additional international collective investment schemes or engage in any other licensable activity, unless the Commission grants its approval by extending the manager's licence to cover those additional activities.

This involves review by the Commission of the scheme's arrangements and documentation for compliance with the regulations. The Commission will also require personal and bankers questionnaires ("PQs and BQs") to be submitted in respect of the scheme's directors, controllers, managers etc. (if a copy of these, no older than 5 years is not already held by the Commission).

A manager of international schemes may however be exempted from the requirement to submit a scheme's documentation for "pre-vetting" provided that the manager can demonstrate a "track record" with regard to compliance with the regulations for international schemes in respect of the manager's three previous international schemes. In such cases the Commission will only require brief details of the additional scheme to be submitted to the Commission (together with completed PQs and BQs) no less than 14 days in advance of the additional scheme's launch date. The Commission has an ["Advance Scheme Notification Form"](#) for this purpose (see [Appendix K2](#)).

Upon receipt of the Advance Scheme Notification Form, the additional scheme will be added to the licenceholder's investment business licence. Notification of the scheme should be submitted within 14 days of the scheme becoming an international scheme using the standard [Notification form](#) in Appendix K2.

Managers who wish to take advantage of this exemption must obtain the written consent of the Commission. The exemption may be lifted should the Commission subsequently find scheme documentation to be unsatisfactory.

2.6 PROFESSIONAL AND EXPERIENCED INVESTOR FUND MANAGERS AND FUND ADMINISTRATORS – Licensing and Regulation

Whilst a PIF or EIF is not specifically required to appoint a manager, it is free to do so.

Should a manager be appointed, an Isle of Man based manager must hold an investment business licence which specifically includes this activity.

The manager may also be an "exempt person", as defined in the Investment Business (Exemption) (Fund Managers) Regulations 1999 (see [Appendix C8](#)). An exempt person is exempt from the requirements to hold an investment business licence so long as it has delegated, with the exception of receipt of management fees and the powers to appoint investment advisers, all activities to an Isle of Man licensed fund administrator. If a representative of the fund administrator takes a place on the board of the manager, that manager may also engage in introducing subscribers to the fund. This ensures that the day-to-day operation of a PIF or EIF is always carried out by an Isle of Man investment business licenceholder and that the arrangements of the PIF or EIF are subject to that licenceholder's oversight.

An existing licenceholder must request an extension to its licence to enable the management or administration of EIFs or PIFs. In assessing whether to grant such approval the Commission will take account of, among other things, the applicant's compliance track record, the quality of its internal systems and control procedures, due diligence procedures for the vetting of business associates, and its financial standing.

New applicants will be required to satisfy the Commission's normal licensing criteria by demonstrating that they are "fit and proper" and that they have appropriate track record and experience in managing and administering funds similar to the EIF or PIF. In addition, the Commission will also take account of the applicant's due diligence procedures for the vetting of business associates, the quality of its internal systems and control procedures and its financial standing. (See also [Licensing Policy](#))

Once approval has been given (unless it is subject to conditions) the manager or fund administrator is free to take on any number of EIFs or PIFs without any further approval from the Commission. A notification of the establishment of each PIF or EIF (using the standard notification form in [Appendix K1](#)) or winding-up of each PIF or EIF must be made to the Commission within 14 days, in accordance with [section 11\(2\)\(a\)](#) of the FSA. In the case of an EIF, at the time of notification, the approved person must certify to the Commission that the offering document and relevant constitutional documents comply with the requirements of the [EIF Order](#).

In permitting a manager or fund administrator to act for PIFs or EIFs, the Commission may impose special conditions upon the way in which the licenceholder undertakes its activities.

The Commission will review the [PIF](#) and [EIF](#) documentation and, during the course of its supervisory visits, inspect the licenceholder's operational activities to seek to ensure that the conditions of the PIF and EIF Order and other relevant Isle of Man regulatory requirements, which concern the conduct of investment business, have been met.

It should be emphasised that the responsibility for the proper management and administration of an EIF or PIF rests with the licensed fund manager of fund administrator.

It should be noted that an exempt person cannot appoint an investment adviser without the prior written approval of the fund administrator.

The Commission has issued Guidance Notes for Managers, Fund Administrators, Custodians and Fiduciary Trustees of EIFs (see [Appendix C9](#)).

2.6a OVERSEAS FUND MANAGERS AND FUND ADMINISTRATORS – Licensing and Regulation

In accordance with the Overseas Fund Order (see [Appendix C12](#)), an overseas fund must be managed or administered by the holder of an investment business licence which specifically permits the provision of management or administration services to an overseas fund. An "overseas fund" is defined in the Overseas Fund Order.

An existing licenceholder must request an extension to its licence to enable the management or administration of an overseas fund. In assessing whether to grant such approval the Commission will take account of, among other things, the applicant's compliance track record, the quality of its internal systems and control procedures, due diligence procedures for the vetting of business associates and its financial standing.

New applicants will be required to satisfy the Commission's normal licensing criteria by demonstrating they are "fit and proper" and that they have appropriate track record and experience in managing and administering collective investment schemes. In addition, the Commission will take account of the matters mentioned above. (See also [Licensing Policy](#).)

In permitting a manager or fund administrator to act for overseas funds, the Commission may impose special conditions upon the way in which the licenceholder undertakes its activities.

Once approval has been given (unless it is subject to conditions), the manager or fund administrator is free to take on any number of overseas funds without any further approval from the Commission.

The Commission wishes to be kept informed of the number of overseas funds administered by its licenceholders and the "Notification Form for Overseas Funds" (see [Appendix K3](#)) should be used for providing such notification. The notification form for each overseas fund should be submitted to the Commission within 14 days of the overseas fund entering into a fund management or fund administration agreement with the licenceholder.

Should an overseas fund cease to be managed or administered by a licenceholder, the licenceholder should notify the Commission in writing within 14 days of the termination of the fund management or fund administration agreement.

The form to be used to provide notification that an overseas scheme is to become subject to S11 of the FSA is [Appendix K1](#).

It should be emphasized that the responsibility for the proper management and administration of an overseas fund rests with the licensed fund manager or fund administrator. Such schemes are unregulated schemes in that they are exempted from the legal and regulatory requirements that apply to other international schemes (including PIFs and EIFs). The Commission expects therefore that licenceholders will be extra vigilant when conducting due diligence on overseas schemes.

Licenceholders of overseas funds should be aware of the Guidance Notes on Domicile of International Schemes (see [Appendix C11](#)).

2.7 THIRD PARTY FUND ADMINISTRATORS - Licensing and Regulation

When the regulatory regime for international collective investment schemes was introduced in March 1990, the Commission recognised that the development of the Island's collective investment scheme industry would be assisted by encouraging the development and growth of third party fund administrators, who would administer the businesses of international collective investment scheme managers who would become known as "managed managers". This concept was subsequently extended to include the managers of authorised schemes. Third party fund administrators are also able to administer professional and experienced investor and overseas funds and, on a managed basis, those organisations whose investment activities are limited to managing the investments of captive and mutual insurance companies.

Providing services as a third party fund administrator in the aforementioned circumstances requires an investment business licence. In considering an application to act as third party fund administrators the Commission will particularly seek to satisfy itself that the level of investment in data processing and information systems is adequate and that proper provision has been made for operational and data security, including arrangements for backup in the event of a systems failure.

The Commission will normally expect that organisations offering third party fund administration services will be organisations of considerable size, or which are part of larger groups offering similar services. (See also [Licensing Policy](#).)

In certain circumstances licensed banks may also be permitted to provide third party fund administration services. Banking institutions contemplating taking on an appointment as third party fund administrator should note the provisions of [paragraph 10.2](#) of the Banking (General Practice) Regulatory Code 1999 (S.D. No: 122/99) which states:-

"The banking institution shall obtain the consent of the Commission - in writing - before accepting an appointment as third party fund administrator to a collective investment scheme."

Before granting such consent, the Commission will require to be satisfied that the banking institution in

question is adequately resourced both financially and in terms of qualified personnel and systems to fulfil its obligations to investors as well as the promoters of authorised and international collective investment schemes.

2.8 REGULATORY CODES, LICENCE CONDITIONS AND KNOW YOUR CUSTOMER

Regulatory Codes ("the Codes")

Under the powers contained in [section 6](#) of the IBA the Commission has made the following regulatory codes:

- [Financial Resources and Compliance Reporting](#)
- [Audit Requirements](#)
- [Clients' Money](#)
- [General Requirements](#)
- [Clients' Investments](#)
- [Advertising](#)
- [Conduct of Business](#)

Each of the Codes is described in further detail below. All investment business licenceholders must comply with the Codes. Failure to do so will lead to the Commission taking appropriate enforcement action. It should be noted that Category 5 licenceholders (Stockbrokers), however, are covered by a separate code - the Financial Supervision Commission (Stockbrokers) Code which is available upon request from the Commission.

2.8.1 Financial Resources and Compliance Reporting - (Appendix E1)

The financial resources requirements are designed to promote a stable and orderly business environment which inspires confidence by minimising the risk of loss to investors which could arise from over-trading by a licenceholder or from adverse developments in the markets in which it operates. No system can eliminate risk and so the Commission's objective is to minimise risk, without over-regulating those licenceholders conducting legitimate and well resourced investment business. The requirements are directly related to the scope of investment business conducted by the licenceholder and therefore depend upon which category of business it is permitted to conduct. The categories of licenceholders in respect of the management and administration of collective investment schemes are as follows:

Category 2(b)

(Minimum net tangible assets of £30,000 and 3 months annual audited expenditure to be maintained as liquid capital)

- managers of international collective investment schemes (apart from experienced investor funds or professional investor funds), but only where the manager is administered by a licenceholder who is authorised as a category 4 business.

Category 3(a)

(Minimum net tangible assets of £50,000 and 3 months annual audited expenditure to be maintained as liquid capital)

- managers of international collective investment schemes (except as provided in category 2(b) above), (apart from experienced investor funds or professional investor funds), and managers of more than one "exempt international collective investment" scheme within the meaning of section 11(7) of the FSA.

Category 3(b)

(Minimum net tangible assets of £75,000 and 3 months annual audited expenditure to be maintained as liquid capital)

- Managers of authorised collective investment schemes;
- Managers or administrators of professional investor funds and/or experienced investor funds.
- Managers or administrators of overseas funds

Category 4

(Minimum net tangible assets of £175,000 and 3 months annual audited expenditure to be maintained as liquid capital - see above)

- licenceholders providing administrative services to managers of authorised and/or international collective investment schemes including PIFs and EIFs (except as provided for in categories 2(b) and 3(b) above).

There are two separate tests of the financial resources of licenceholders - the minimum net tangible asset test and the liquid capital test. The two tests reflect two measures of the solvency of a business; that its assets should exceed its liabilities and that it should be able to meet its liabilities as they fall due.

The net tangible assets test applies to all categories of licenceholder and requires every licenceholder to commit capital resources to the business scaled broadly in line with the requirement for investment in equipment, etc.

The liquid capital test, which applies to all categories except category 1, is an expenditure-based requirement which focuses upon realisable assets available against a number of months expenditure. The intention is that each licenceholder should have enough liquid working capital to sustain its business for a number of months to provide a cushion against unexpected market shocks or disruption of business and provide time, if necessary, for an orderly reconstruction or winding down of the business.

In addition, the Commission believes that all licenceholders should carry professional indemnity insurance. The level of insurance required is dependent upon the category of business being conducted. For example, category 1 businesses ought to hold professional indemnity cover of not less than £250,000 or three times total revenue, whichever is the greater, whereas the minimum level for higher categories is £500,000. This requirement recognises that licenceholders are subject to a range of different types of risk (e.g., negligence), not all of which can be reduced by a financial resource requirement.

This code contains details of how the financial resource requirements are to be calculated and specifies a number of adjustments. One of the most important of these adjustments is that monies owing to the licenceholder from other group companies will be excluded for the purposes of calculating the financial resource requirement, except in certain very limited circumstances. Thus, a licenceholder will be expected to "stand alone" financially from the rest of its group.

Although the financial resource requirement is a day-to-day requirement, licenceholders are required to submit financial statements to the Commission at periodic intervals, generally either half-yearly or quarterly depending upon the category of licence.

The Commission attaches great importance to accurate and timely reporting. Late, incomplete, or inaccurate returns are never a good sign and are often a symptom of serious problems. In any case, prompt and accurate reporting is an important part of the Commission's criterion that the business shall be conducted with prudence and professional skill, which is part of the "fit and proper" test.

2.8.2 [Clients' Money - \(Appendix E2\)](#)

This code should be read in conjunction with the Investment Business (Clients' Money) Regulations 1991 ("the Regulations") (see [Appendix E8](#)).

One of the main purposes of this code and the Regulations is to provide for the protection of clients' money in the event of the insolvency of the licenceholder, i.e., to ensure that a liquidator is unable to claim clients' monies as part of the general assets of the licenceholder. Thus, a fundamental requirement of the Regulations and the code is that clients' money should at all times be held in segregated and properly designated accounts on trust for the investor. The Commission requires bankers to provide confirmation that monies held in such accounts are not subject to any charge or lien, right of set-off, etc.

Additional safeguards have been included in this code for those situations where clients' money is paid into bank accounts abroad. In such circumstances, it is the responsibility of the licenceholder to ensure and demonstrate to the Commission that clients' money held in such accounts is afforded similar protection to that provided under the Island's code and Regulations. If this cannot be done the licenceholder must warn the client in writing that his money may not be as well protected (see [paragraph 6.1\(d\)](#) of the Clients' Money Code).

The other main aim of this code is to ensure that clients' monies are properly recorded, reconciled and controlled so that money belonging to one client is not utilised to meet the liabilities of either the licenceholder or another client. Special provisions are included for clients with a high volume of investment transactions and for those undertaking margined transactions (e.g. futures).

2.8.3 [Clients' Investments - \(Appendix E3\)](#)

The principal objective of this code is to ensure that, where licenceholders have possession or control of investments belonging to others, adequate arrangements are maintained to ensure that such investments are kept safely and are properly recorded, identified, segregated and controlled so that at any time investments belonging to others are accounted for and no administrative or financial difficulties to which the licenceholder may be exposed would have adverse consequences for those clients or other persons. The code recognises that licenceholders may hold clients' title documents on a temporary basis while they are in transit to clients. In such circumstances, the code will not be applied as long as the title documents are registered in the name of the client and are forwarded to him within 2 business days.

This code requires that a licenceholder must not recommend to a client that any other person should have custody of or should act as the registered holder of the client's investments unless that person is an "eligible custodian". An eligible custodian can be either an approved banking institution, a nominee company with no other business which acts solely in accordance with the directions or instructions of the licenceholder (in which case the nominee will be regulated through the licenceholder) or an institution providing custodial services in another territory which, in the opinion of the Commission, is adequately supervised by a regulatory body or Government agency in that territory. The licenceholder is responsible for ensuring that the custodian acknowledges in writing that the provisions of the code will be complied with by such custodians.

The Commission requires all licenceholders and any "eligible custodians" to maintain adequate insurance for non-registered securities which are in their possession at any time, against negligence, accidental loss, fire, flood, theft and employee fidelity.

The Code also requires that written statements of investments held should be provided to each client normally twice a year after a complete reconciliation of clients' title documents has been carried out by the licenceholder and any "eligible custodians". In certain circumstances, the

Commission is prepared to allow licenceholders to adopt a "rolling" basis of reconciliation. Before doing so, however, the Commission will require a report from the licenceholder's auditors on the adequacy of the licenceholder's system of internal controls for recording client investments.

2.8.4 [Conduct of Business - \(Appendix E4\)](#)

This code describes the general principles and standard of conduct which the Commission expects licenceholders to adopt in their dealings with clients and others. Throughout the code, the distinction is drawn from time-to-time between the private investor (i.e., the man in the street) and the experienced or professional investor. All clients will be deemed to be private investors unless they have elected in writing not to be.

The Commission considers that the private investor requires a greater level of protection than the experienced or professional investor and this is reflected in the Code. Where no distinction is drawn, the Commission considers that a similar level of protection is appropriate for all types of client.

The Code is self explanatory and is divided into 7 main headings:

- i. integrity and fair dealing;
- ii. skill, care and diligence;
- iii. disclosure and information;
- iv. acting with agreement;
- v. responsible conduct;
- vi. futures, options and contracts for differences; and
- vii. documentation and records.

2.8.5 [Audit Requirements](#)

This code requires that auditors of investment businesses are restricted to those firms which are covered by professional indemnity insurance of not less than £10 million. The Commission also wishes to be satisfied that the firm has sufficient knowledge and expertise in this specialised area and that the partner in charge of the audit can demonstrate that he has adequate experience. The Commission also prefers the auditors of its licenceholders to have local representation in the Isle of Man.

The code lays down specific requirements for the letter of engagement between the licenceholder and its auditor. These specify the rights and duties of the auditor and include also a number of specific audit report requirements which are contained within this code. The code requires the auditor to make reports to the Commission in relation to the Financial Resources and Compliance Code, the [Clients' Money Code](#), the [Clients' Investments Code](#) and specific parts of the [Conduct of Business Code](#) and these reports play an important part in the effective enforcement of the Codes.

2.8.6 [General Requirements - \(Appendix E6\)](#)

The overriding principle within this code is contained in paragraph 3 which states:

"A licenceholder should co-operate in an open and honest manner with the Commission and any other regulatory body to which it is accountable and should keep them promptly informed of anything relevant to the Regulator's task."

Indeed, the Commission believes that compliance with this code is a substantive test of a licenceholder's continued fit and proper status and would not expect any licenceholder to have difficulty with it.

Dual Control ("four-eyes" control)

The code lays down several fundamental requirements, perhaps the most important of which is the requirement for the business of licenceholders within categories 2 to 4 to be conducted on a day-to-day basis by at least 2 individuals (the "4-eyes" principle). The Commission must be satisfied that the individuals proposed to fulfil the four-eyes requirement are competent and that they are people of integrity - but they must also have the maturity and strength of character to act with proper independence of mind. The Commission writes, as a matter of routine, to the individuals proposed by the licenceholder, describing its requirements and reminding them that failure to carry out their responsibility has implications for their "fit and proper" status (See [Appendix G4](#)). In addition, the Commission will generally wish to interview those who will be acting as the licenceholder's "4-eyes". In order to appoint, or replace an individual who forms part of the four-eyes control, the licenceholder must write to the Commission to recommend an appropriate individual. The Commission has the right to object to the person proposed.

The concept of four-eyes control seeks to prevent the day-to-day management of a licenceholder and its affairs being carried on under the influence of a dominant individual, whether that person is an owner, controller or a director.

The Commission requires, wherever possible, the persons responsible for the "4-eyes" not to be also responsible for compliance matters.

This code also lays down certain notification requirements, some of which are, for obvious reasons, immediate ("forthwith") while others are designed to enable proper consideration and discussion to take place before a change is implemented. For example, 21 days notice must be given to the Commission prior to the appointment of any new director, manager, or secretary.

Directors responsibilities

The Commission is concerned to ensure that directors accept their responsibilities for the proper conduct and financial well-being of an Isle of Man licenceholder. Accordingly, the Commission has issued Guidance Notes on the responsibilities and duties of directors under the laws of the Isle of Man (see [Appendix I3](#)).

Company Secretary

[The General Requirements Code 5](#) requires the company secretary of a licenceholder either to be properly qualified in accordance with section 19(4), paragraphs (a) to (e) of the Isle of Man Companies Act 1982 or, exceptionally, an individual who, by virtue of his knowledge and experience, is specifically approved by the Commission to act as company secretary.

Normally, the Commission would not expect the Managing Director of a licenceholder to also act as company secretary.

Compliance Officer

The Commission deems the person responsible for compliance matters (i.e. the Compliance Officer/Manager) a "manager" for the purposes of [General Requirements Code 7.2](#). Accordingly, it should be noted that the Commission must be appropriately notified of the appointment or resignation of the compliance person. The Commission also requires, wherever possible, the persons responsible for the day to day operation of the business of the licenceholder (i.e. the "4-eyes") should not be responsible for compliance matters.

Commission Approval

Other parts of the code require licenceholders to obtain Commission approval before certain important changes are effected (e.g. acquisitions, mergers, etc.).

2.8.7 Advertising - (Appendix E7)

The term "advertisement" is defined in the IBA as follows:-

"Every form of advertising whether in a publication or by the display of notices or by means of circulars or other documents or by an exhibition of photographs or cinematograph films or by way of sound broadcasting or television (including transmission by cable)."

This definition includes scheme particulars, prospectuses and any other offer documents.

The Commission does not require licenceholders to submit draft advertisements for approval prior to publication. However, this code lays down general principles relating to advertisements to which licenceholders should adhere.

The code is divided into two sections:

- a. General Requirements. These are basic principles which apply to any advertisement. For example "an advertisement shall not contain a statement, promise or forecast which is untrue or misleading".
- b. Requirements relating to specific investments. These are designed to ensure that advertisements disclose adequately any special areas of risk in the investment product being advertised. In the case of advertisements inviting direct investment in futures, options and contracts for differences, it is a requirement that a specific risk warning be included as follows:

"The risks of loss from investing in commodity and financial futures, foreign exchange contracts, securities and index contracts and options can be substantial".

This requirement is, of course, consistent with the Commission's requirements under the [Conduct of Business Code](#).

2.8.8 Licence Conditions

The Commission's regulation and supervision of investment business licenceholders is founded upon the system of the Codes. However, [section 3\(4\)](#) of the IBA empowers the Commission to issue investment business licences subject to conditions. Normally, the only licence condition that managers, fund administrators and third party fund administrators will find attached to their investment business licence upon issue will be one that prescribes the scope of the investment business activities that they may carry on. For example, a manager of authorised schemes will be licensed subject to the condition that it acts only as manager of the schemes named in the schedule attached to the licence.

It is important that licenceholders appreciate the significance of the difference between licence conditions and the Codes. Whereas a breach of a regulatory code can lead to regulatory enforcement action being taken by the Commission, a contravention of a licence condition risks criminal prosecution and/or civil action at the suit of anyone who suffers loss.

2.8.9 "KNOW YOUR CUSTOMER"

Although the nature of a licenceholder's business is within the control of the Board and management, the Commission has long been aware of the risk of abuse of the Island's investment businesses by criminals. As long ago as 1985, the Commission introduced a "Know Your Customer" policy, designed to alert investment businesses to the dangers of doing business with people they did not know and of relying solely upon introductions from the marketplace. The Know Your Customer policy requires licenceholders to seek evidence of identity, to verify

that identity, to enquire as to the nature of the business and activity of the customer and to monitor the activity of any doubtful accounts.

Since then, there have been numerous international initiatives to combat money laundering - the Basel Supervisors Committee introduced its Statement of Principles in December 1988; the G7 countries formed a Financial Action Task Force on money laundering in June 1989, which produced its Recommendations in April 1990; and in December 1990 the Joint Money Laundering Working Group in the UK produced its Guidance Notes for Banks and Building Societies. The Criminal Justice Act 1990, as amended, contains comprehensive provisions relating to the countering of "all-crimes" money laundering. The Anti-Money Laundering Code, which came into force on 1 December 1998, applies to investment businesses and the Commission has produced [Anti-Money Laundering Guidance Notes](#) for its licenceholders.

Compliance with the Island's Anti-Money Laundering requirements is a requirement of the Commission's [Conduct of Business Regulatory Code](#), as well as a recommendation pursuant to [section 9 of the IBA](#).

2.9 Compliance Procedures

The Financial Supervision Commission (Conduct of Business) Regulatory Code at [paragraph 6.7](#) states: -

"Compliance

A licenceholder should establish and maintain compliance procedures in writing where appropriate with a view to ensuring that: -

- a. its officers, employees and other representatives are aware of their obligations under the [Investment Business Act 1991](#) and any licence conditions, codes or regulations and are able to comply with them; and
- b. sufficient information is recorded and retained about the conduct of the licenceholder's business and its compliance with the [Investment Business Act 1991](#) and any licence binding upon it.

Compliance procedures should be in writing where the staff of the licenceholder exceeds ten.

A licenceholder should, at least annually, carry out a review of its compliance procedures to ensure that they are effective and have been complied with."

It is important that licenceholders are able to demonstrate compliance with all regulatory codes which impact upon them. The maintenance of comprehensive procedures and compliance manuals will assist licenceholders to evidence compliance with the above code and a review of such manuals will form a key part of supervisory visits. Licenceholders are also required to submit a Compliance Statement to the Commission on an annual basis in accordance with the Financial Resources and Compliance Regulatory Code.

2.10 Supervisory And Focused Visits

The Commission's aim in conducting a programme of Supervisory and Focused Visits on its licenceholders is to promote high standards amongst those it regulates by identifying instances where investors or indeed, the licenceholder, may be at risk or where the standards and practices required by the Regulatory Codes are not being observed.

Specifically, the Supervision programme is to: -

- Assess whether those the Commission regulates remain fit and proper persons;
- Identify potential weaknesses in controls or procedures which may cause regulatory concern;
- Identify and investigate instances where investors' interests may be at risk from any failure to comply with the regulatory requirements;
- Assist those involved in investment business in understanding and meeting the Commission's requirements.

Commission's officers normally undertake supervisory visits on licenceholders at a pre-arranged time when the licenceholder is required to demonstrate that the requirements of the regulatory codes have been met. Reviews are not intended to be a comprehensive investigation of the licenceholder's activities. Whilst the Commission's Officers may suggest certain remedial actions and provide guidance where appropriate, it remains the ultimate responsibility of the licenceholder's Board to ensure the financial well-being and efficient management of the licenceholder, including compliance with the regulatory requirements and to protect the interests of shareholders.

Officers may conduct full Supervisory Visits, which extend to all activities carried on by the licenceholder, including any non-investment business and which will be undertaken over a number of days, or Focused Visits, concentrating on a particular area or areas such as [Know Your Customer](#) or [Clients' Money](#) which may be concluded in a shorter timescale.

Each area reviewed will be given a rating ranging from Good to Unsatisfactory. In addition, the visit will be given an overall rating. The Commission expects those issues rated as "Unsatisfactory" to be dealt with or brought into compliance as a matter of urgency while those issues rated as "Room for Improvement" will be given a period of time in which to comply. Evidence of such action, in the case of "Unsatisfactory" issues, will need to be supplied to the Commission within the timescales given or, in the case of "Room for Improvement" will be reviewed at the next Supervisory Visit.

It should be noted that an "Unsatisfactory" rating may have an impact on the ["fit and proper"](#) status of the licenceholder and its management. Licenceholders will recall that the "fit and proper test" is both an initial test at the time of granting a licence and a continuing test in relation to the conduct of business and the relationship with the Commission. The Commission's approach is cumulative and it

may therefore conclude that the "fit and proper test" is not met on the basis of a number of instances of conduct, which, if taken individually, might not lead to that conclusion.

It should be noted that the Commission's officers are bound by the strict rules of confidentiality laid down in [sections 23 and 24 of the Financial Supervision Act 1988](#).