



ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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Guidance Note – Exempt Schemes

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STATUS OF GUIDANCE

The Isle of Man Financial Services Authority issues guidance for various purposes, including to illustrate good practice, to assist relevant persons in complying with legislation and to provide examples or illustrations. Guidance is, by its nature, not law, however it is persuasive. Where a person follows guidance this would tend to indicate compliance with the legislative provisions, and vice versa.

1. What is an Exempt Scheme?

An **Exempt Scheme** is an arrangement which meets the meaning of a “collective investment scheme” under section 1 of the Collective Investment Schemes Act 2008 (“[CISA08](#)”) and the “Exempt Schemes” requirements under Schedule 3 to the CISA08.

Section 1 of the CISA08 states:-

Meaning of collective investment scheme (“scheme”):

(1) “Collective investment scheme” means arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming or being owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of those profits or income.

(2) The arrangements must be such that the persons who participate (“participants”) do not have day to day control over the management of the property, whether or not they have the right to be consulted or to give directions.

(3) The arrangements must also have either or both of the following characteristics -

(a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;

(b) the property is managed as a whole by or on behalf of the governing body of the scheme.

(4) If arrangements provide for pooling in relation to separate parts of the property, the arrangements are not to be regarded as constituting a single collective investment scheme unless the participants are entitled to exchange rights in one part for rights in another.

Schedule 3 to the CISA08 states:-

Exempt Schemes:

(1) A scheme is an exempt scheme if —

(a) it has less than 50 participants;

(b) the documents constituting the scheme —

(i) prohibit the making of an invitation in any part of the world to the public or any section of it to become or offer to become participants in the scheme; and

(ii) do not imply that the scheme is regulated under this Act or otherwise; and

(c) it complies with the requirements of sub-paragraph (2).

(2) To comply with this subparagraph the scheme must be —

(a) a unit trust scheme established under and governed by the laws of the Island;

- (b) an open-ended investment company formed or incorporated under —*
- (i) the Companies Acts 1931 to 2004; or*
 - (ii) the Companies Act 2006;*
- (c) a limited partnership registered in the Island under Part II of the Partnership Act 1909; or*
- (d) such other description of scheme as is prescribed.*

(3) The exemption provided by sub-paragraph (1) does not apply to a scheme where units are held by participants as a result of an invitation in any part of the world to the public or any section of it by any person.

An **Exempt-type Scheme**¹ is a term used to describe a scheme established outside the Isle of Man (“IOM”) that is subject to similar restrictions as the IOM Exempt Scheme.

The [Collective Investment Schemes \(Definitions\) Order 2017](#) also sets out arrangements which do not amount to a scheme.

What constitutes a scheme, including an Exempt Scheme, can be complex and legal advice should be taken on individual circumstances.

2. Participants in an Exempt Scheme

As noted above a scheme will only be an Exempt Scheme if it has less than 50 participants.

Section 26 of the CISA08 (Interpretation) states that the word ‘participants’ has the meaning given in section 1 of the CISA08 (see above). The Authority expects that a participant in a scheme must have an economic interest in the scheme.

In general, the participant in a scheme will be the shareholder or unitholder named on the share register or the list of unitholders of the scheme. Exceptions will be where the name on the register is that of a nominee or trustee, which holds the shares or units² on behalf of an underlying beneficiary.

Because a nominee shareholder or trustee does not have an economic interest in the scheme (i.e., it is not the beneficial owner of that interest), the Authority considers that a nominee shareholder or trustee is not a participant in a scheme but rather represents a participant or a number of participants. Therefore for the purposes of the 50, the underlying participants should be counted.

¹ See Regulated Activities Order 2011, Schedule 2 - Interpretation

² See CISA08, s26

It is the Authority's view that this interpretation preserves the spirit of an Exempt Scheme, being a vehicle for accommodating private arrangements and in which shares or units are only made available to a limited number of investors (less than 50).

The above is not, however, a legal interpretation of the term "participants".

3. Prohibition on invitation to the public

An Exempt Scheme's constitutional documents must prohibit the making of an invitation, or offer, in any part of the world to the public, or any section of it, to become participants in the scheme.

This means there should be no advertisements, or similar, making an invitation or offer to the public to become participants in a scheme or containing information intended to lead directly or indirectly to persons becoming participants in a scheme.

This includes:

- a website for a scheme
- documents constituting a scheme that have been made available on a public website
- social media sites

4. Licensing requirements

Functionaries (such as managers, administrators, trustees, fiduciary custodians or custodians) that provide services in or from the Isle of Man to Exempt or Exempt-type schemes are required to be licensed under the Financial Services Act 2008 ("FSA08") to conduct Class 3(11) regulated activity set out within the Regulated Activities Order 2011 ("[RAO](#)"), unless the activity falls under an exemption.

A Class 3(12) permission is required to provide administration services to a person who is undertaking Class 3(11) regulated activity but who is exempt from licensing by virtue of paragraphs 3.2 or 3.6 of the Financial Services (Exemptions) Regulations 2011 ("[Exemptions Regulations](#)") – see below.

The exemption from licensing at 3.2 of the Exemption Regulations in relation to regulated activity falling within Class 3(11) of the RAO is very narrow. It applies if a person only provides services to one Exempt or Exempt-type Scheme and satisfies the specified conditions. There are other exemptions under 3.6 of the Exemption Regulations available for functionaries of Exempt or Exempt-type schemes which are wholly-owned subsidiaries of licenceholders; full details can be found in the Exemptions Regulations.

5. Legislation and Guidance

The name “Exempt Scheme” does not mean that such a scheme is exempt from all legislation. The [CISA08](#) still applies to exempt schemes and the Financial Services Rule Book 2016 (“[FSRB](#)”) still applies to licenceholders providing services to Exempt and Exempt-type schemes.

As well as the general requirements of the FSRB applicable to all licenceholders, those providing services under Class 3(11) and 3(12) should consider the additional requirements and responsibilities under CISA08 and the FSRB, including reporting requirements, and ensure they have in place appropriate resources, procedures and compliance arrangements (see **Appendix 1** – key additional requirements for Class 3(11/12) regulated activity).

With reference to the FSRB, the Authority may consider requests from licenceholders for certain rules to be modified or for them to be dis-applied (called “exceptions”). In such circumstances a licenceholder must explain and justify why it believes an exception or modification is appropriate.

All schemes established in the IOM under CISA08 fall into the definition of “relevant persons” under the Proceeds of Crime Act 2008 (“POCA”) for the purpose of AML/CFT legislation. This means the Anti-Money Laundering and Countering the Financing of Terrorism Code 2019 (“AML/CFT Code”) applies to the schemes themselves. Further information is provided in **section 6** of this guidance.

Other guidance applicable to all types of scheme should also be considered:-

- [The use of companies incorporated under the Companies Act 2006](#)
- [Governance of Collective Investment Schemes](#)
- [Protected Cell Companies](#)
- [AML/CFT Handbook](#)
- [Rule Book Guidance](#)
- [Pricing Errors](#)

6. AML/CFT Compliance

A collective investment scheme (within the meaning of section 1 of CISA08) is specified as a ‘business in the regulated sector’ under Schedule 4 to POCA and is subject to the requirements of the AML/CFT Code (as a ‘relevant person’).

The governing body (“board”) is responsible for a scheme’s compliance with all relevant provisions of the AML/CFT Code. In practice however, such activity is often delegated to the

scheme's appointed manager/administrator. Despite any such delegation, the governing body is ultimately responsible for the scheme's compliance with the AML/CFT Code.

Where such delegations are made, the agreement between the scheme and the appointed functionary ('Functionary Agreement') should explicitly state which party is undertaking the activity with regards to AML/CFT Code. Where matters are delegated to the appointed functionary, the agreement should detail how such activities will be monitored and reviewed by the board of the scheme. The role of the MLRO should also be referenced within the Functionary Agreement, as well as any of their reporting responsibilities required under the AML/CFT Code.

For the avoidance of doubt:

- Where an Isle of Man licenceholder only undertakes some of the AML/CFT activities on behalf of the scheme, the Authority expects the licenceholder to have confirmed and documented which party is responsible for the remaining activities and can provide evidence to this effect.
- An Isle of Man licenceholder providing services to an Exempt Scheme, where those services include the scheme's compliance with the AML/CFT Code, should consider both the scheme and the underlying investors in the scheme as 'customers' for the purposes of AML/CFT legislation. Requirements such as the completion of customer risk assessments and collection of CDD information therefore applies to both the scheme (as a customer of the licenceholder) and the underlying investors (as customers of the scheme).

7. Requirements for Isle of Man licenceholders

The Authority has the following expectations of Isle of Man licenceholders acting as Managers or Administrators to Exempt Schemes:

If an administrator is appointed by the governing body of an Exempt Scheme, the administrator should undertake the functions of "administration" (insofar as they are relevant) as defined under section 26 of CISA08:

- (a) accounting services;*
- (b) handling of administrative enquiries from participants;*
- (c) valuation of assets and pricing of units;*
- (d) maintenance of the register of participants;*
- (e) distribution of income;*
- (f) issues, transfers and redemptions of units; and*

(g) record keeping.

Details should form part of the agreement between the scheme and the licenceholder, as the administrator.

If a manager is appointed by the governing body of an Exempt Scheme, the manager should be responsible:-

(a) for ensuring that the scheme is managed in accordance with the documents constituting the scheme and its offering document; and

(b) for the conduct of the administration of the scheme;

as defined under section 26 of CISA08.

This should be noted in the agreement between the scheme and the licenceholder, as the manager.

The following summarises the minimum requirements of the Class 3 functionalities (licenceholders) contained in primary and secondary legislation, but it is vital to review the legislation directly:-

CISA08

- The manager and/or administrator and the governing body of the scheme should make all reasonable enquiries, to ensure that the scheme meets all of the criteria referred to under CISA08 Schedule 3 on its establishment, and on a continuing basis.
- A person must not act as manager or administrator of a scheme unless it has taken reasonable steps to be satisfied that all service providers to the scheme are suitable to act in the manner envisaged (section 5 of CISA08).
- The manager or administrator of a scheme who knows of or had reasonable cause to believe the occurrence of any matter which has, or is likely to have, a material adverse effect on a scheme must immediately notify the Authority in writing of the occurrence stating the reasons (section 6 of CISA08).

FSRB

- A licenceholder should have sufficient policies and procedures in place specific to its Class 3 activities and relevant legislation.
- In relation to a relevant scheme, a licenceholder must take all reasonable steps to comply with every statement in the most recently published offering document,

explanatory memorandum or other document describing how it will operate the scheme and comply with the duties imposed on the licenceholder under the FSA08 (Rule 6.54 of the FSRB). For example, while there is no requirement for Exempt schemes to produce audited accounts in CISA08, if a scheme's offering document states that they will be produced, this should be adhered to.

- Where a licenceholder carries on any activity relating to a relevant scheme, the interests of the scheme must be the licenceholder's paramount consideration (Rule 6.53(1) of the FSRB).
- Where practicable a licenceholder must avoid conflicts of interest in relation to a relevant scheme, however where a conflict does arise it must be addressed and managed (Rule 6.53(2) of the FSRB). The Authority expects a licenceholder to be able to produce a list of conflicts for each scheme it provides services to, or a document that can be filtered to reflect the conflicts related to an individual scheme.
- A licence holder must, when entering into a financial, banking or other transaction on behalf of the scheme, act in the best interests of the scheme (full details are contained in Rule 6.53(3) of the FSRB).
- A licenceholder must treat all schemes fairly, no scheme should be given an unfair advantage (Rule 6.53(4) of the FSRB)³.
- A licenceholder must ensure that participants are treated fairly in accordance with the terms of the scheme and no participant is given unfair advantage or priority (Rule 6.56 of the FSRB).
- There is a requirement for a written functionary agreement – in order to carry out regulated activity falling within Class 3 there must be a written agreement which sets out the terms on which services are to be provided (Rule 6.60 of the FSRB).
- Contract notes should be issued in accordance with the requirements of Rule 6.63 of the FSRB.
- If there is a specified client bank account for the scheme then this requires compliance by the licenceholder with the relevant rules in Part 3 – Client Money.
- If there is no custodian for the Exempt Scheme, the licenceholder may need to consider if it is holding the custody of the assets of the scheme. Therefore, 'Part 4 – Clients Investments' may be applicable.

³ For licenceholders providing services in respect of more than one scheme.

8. Governance

The Authority expects the governing bodies of schemes to consider the "[Governance of Collective Investment Schemes Guidance Note](#)", and functionaries to schemes should be aware of its content. The document should be considered in its entirety, however the following are some of the key provisions:

- Timely communication between governing bodies, licenceholders and participants.
- Maintenance of conflicts of interest registers for the scheme, with all parties avoiding conflicts of interest where possible and managing or mitigating conflicts of interest otherwise.
- The governing body should assess risks and risk mitigation of the scheme and ensure that those risks are appropriately managed through delegation, controls and procedures.
- Service agreements between the scheme and the licenceholder should explicitly detail all services to be provided.
- Board meetings should be held on a regular basis (as appropriate to the size and connectivity of the participants). Records should be maintained which adequately evidence board discussion and decisions.

In addition, the guidance "[the use of companies incorporated under the Companies Act 2006](#)" should be considered in its entirety, however the following are some key provisions:

- The Authority expects a fund company to have two directors, as a minimum, one of whom should be a natural person.
- It is expected that a fund company will hold an AGM each year and this fact is disclosed within the offering document.
- Minute books should be kept on the Isle of Man, either at the offices of the Manager / Administrator (if they are on the Island) or the Registered Agent.

9. Reporting Requirements and Fees

If a licenceholder acts as a functionary to an Exempt Scheme, the Authority requires the provision of a statistical return – this is to be submitted on a quarterly basis via the Authority's Portal.

A licenceholder applying for a Class 3(11) / (12) licence is subject to an application fee and then an annual fee. The current schedule of fees can be found in the Financial Services (Fees) Order (these fees are also applicable for an existing Class 4 licenceholder who is applying for, or holds, an incidental Class 3 permission).

Appendix 1 – Additional Class 3 Rulebook requirements (in addition to the Rules applicable to ALL licenceholders)

Rule	
Rule 2.30 and Appendices 2 and 3	Financial Resources <i>Minimum Share Capital Requirement</i> <i>Minimum Net Tangible Asset Requirement</i>
Rule 2.33	Requirement to submit interim financial returns
Rule 3.1	Interpretation of “client” in Part 3 for Class 3 licenceholders
Rule 3.30	Client money – Subscription and redemption accounts
Rule 4.1	Interpretation – this explains how rules 4.2 to 4.13 are applied to Class 3 licenceholders
Rule 4.2	Interpretation
Rules 4.3	Clients investments – Records of transactions
Rule 4.4	Records of safe-custody investments
Rule 4.5	Use of custodians
Rule 4.6	Registerable investments
Rule 4.7	Reconciliation of investments and title documents
Rule 4.8	Periodic statements
Rule 4.9	Borrowing from a client
Rule 4.10	Loans of investments
Rule 4.11	Investments etc. held as collateral
Rule 4.12	Safekeeping of clients’ title documents
Rule 4.13	Safekeeping by other persons
Rule 6.53	Interests of scheme to be paramount
Rule 6.54	Observance of terms of scheme particulars
Rule 6.56	Participants to be treated fairly
Rule 6.57	Material interests
Rule 6.60	Requirement for written functionary agreement
Rule 6.63	Contract note etc
Rule 6.72	Provision of Statistical information – quarterly information required
Rule 8.60	Pricing Errors