

Isle of Man Government

MONEYVAL Compliance Enhancing Procedures Report – Isle of Man

Report to the 58th Plenary Meeting of MONEYVAL

15-19 July 2019

Background

This is the Isle of Man's ("IOM") first report under the MONEYVAL Compliance Enhancing Procedures ("CEPS").

It was agreed at the MONEYVAL Plenary of December 2018 that the Isle of Man ("IOM") would enter MONEYVAL's Compliance Enhancing Procedures ("CEPS") and that the IOM should make a report on progress to the July 2019 Plenary. It was identified that the IOM should report on the following three outstanding recommendations from its Mutual Evaluation Report published in December 2016;

Immediate Outcome 3 (Supervision)

- With respect to Immediate Outcome 3 ("Supervision"), the UK Crown Dependency of the Isle of Man should continue demonstrating the effective use of dissuasive sanctions in severe cases

Immediate Outcome 4 (Preventive Measures)

- Taking account of risk, authorities should further limit the circumstances in which CDD information and evidence of identity presented by a third party can be used, including where that third party has collected information from another party (an information chain).
- Authorities should require FIs to take account of risks presented by underlying customers when applying CDD exemptions to intermediary customers under paragraph 21 of the AML/CFT Code. Application of the exemption should also be prohibited where specific higher risk scenarios apply. Requirements to sample-test whether CDD and record-keeping requirements are appropriately applied to underlying third parties should be reviewed and alternative measures put in place, as necessary, to mitigate risk

IMMEDIATE OUTCOME 3

1. With respect to Immediate Outcome 3 ("Supervision"), the UK Crown Dependency of the Isle of Man should continue demonstrating the effective use of dissuasive sanctions in severe cases.

1.1 In the IOM's MER the relevant IO3 Recommended Action was that "The IOMFSA should, in severe cases, make greater use of sanctions." The Isle of Man Financial Services Authority ("IOMFSA") continues to use the full range of its sanctioning powers as and when required. The table below shows ongoing significant enforcement cases and cases dealt with by the IOMFSA since January 2017 (following the publication of the MER in December 2016).

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Subject Name	Type of Investigation (Civil/Criminal/Regulatory)	Enforcement action	Outcome
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 15 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 6 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 7 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 8 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 5 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 3 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 6 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 8 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 12 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 5 years
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Disqualified for 6 years
Apex IOM Limited	Criminal and Regulatory	AML/CFT Code & Financial Services Rule Book	Criminal Prosecution under the AML/CFT Code. Fine issued of £13,500. Regulatory Civil Penalty issued of £91,682.
Accountant	Regulatory	Found not fit and proper under section 11(a) of the Designated	Registration revoked – business closed down

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		Business (Registration and Oversight) Act 2015	
Convertible virtual currency	Regulatory	Found not fit and proper under section 11(a) of the Designated Business (Registration and Oversight) Act 2015	Registration revoked – business closed down
Accountant	Regulatory	Found not fit and proper under section 11(a) of the Designated Business (Registration and Oversight) Act 2015	Registration revoked – business closed down
Accountant	Regulatory	Refused registration application	Business not allowed to operate in the IOM.
Licenceholder and connected funds	Civil and Regulatory	Various options open	Ongoing
Operation Silverdale	Criminal and Regulatory	Criminal - contraventions of the AML/CFT Code and Regulatory - continued fitness and propriety	Ongoing
Operation Marvel	Civil and Regulatory	Regulatory Investigation into AML/CFT Code contraventions and continued fitness and propriety	Ongoing
Operation Lego	Civil and Regulatory	Regulatory Investigation into AML/CFT Code contraventions and continued fitness and propriety	Ongoing
Operation Tolkien	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Ongoing
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Ongoing
Officer disqualification	Civil	Disqualification under the Company Officers (Disqualification) Act 2009	Ongoing

Disqualification in the above table means being disqualified from acting as:-

- a director, secretary or registered agent;
- a liquidator;
- a receiver;
- a person holding an office under any relevant foreign law analogous to any of the offices specified in paragraph (a), (b) or (c) in respect of a company; or
- a person who, in any way, whether directly or indirectly, is concerned or takes part in the promotion, formation or management of a company.

1.2 The IOMFSA will very shortly have full powers to issue civil penalties and not just for administrative errors, thereby increasing its range of sanctioning options. The Anti-Money Laundering and Countering the Financing of Terrorism (Civil Penalties) Regulations 2019 have

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been made and are due to be approved by Tynwald (the IOM Parliament) at its sitting on 18th June 2019. If approved they come into force and effect the following day. A copy of the Civil Penalty regulations can be found at Attachment 1.

The fines will be levied depending on the nature of the offences/ breaches and will operate as follows;

Level 1: A penalty may be imposed at this level if the Authority is satisfied that none of the factors specified in regulation 5(3) (see at Attachment 1) is present. The penalty may be up to 5% of the relevant person's income.

Level 2: A penalty may be imposed at this level if the Authority is satisfied that any of the factors listed in regulation 5(3) (see at Attachment 1) is present. The penalty may be up to 8% of the relevant person's income.

The enabling legislation for the new civil fining powers is the Proceeds of Crime Act (Compliance with International Standards) Order 2019, which can be found at Attachment 2 and the Terrorism and Other Crime (Financial Restrictions) Act (Section 69A) Order 2019, which can be found at Attachment 3. Both of these Orders will also be presented for approval at the June sitting of Tynwald and come into effect the day after approval is granted.

IMMEDIATE OUTCOME 4

2. **Taking account of risk, authorities should further limit the circumstances in which CDD information and evidence of identity presented by a third party can be used, including where that third party has collected information from another party (an information chain).**
- 2.1 The IOM has drafted a new Anti-Money Laundering and the Countering the Financing of Terrorism Code 2019 ("the Code"). The draft has been consulted upon and the Code has been finalised; it is in the final legislative stage. The Code is secondary legislation and is made by the Department of Home Affairs. The Code is made when it is signed by the Minister for that department. The Code was signed on the 2nd May 2019. Legislation that is made by a Minister is required to be 'laid before' Tynwald¹. The Code will therefore be laid before Tynwald (the IOM Parliament) on 21 May 2019 and currently is expected to formally come into operation on 1 June 2019. The IOM will confirm this with MONEYVAL on that date.
- 2.2 The Code which has been made by the Department of Home Affairs and which will be laid before Tynwald is attached at Attachment 4.
- 2.3 A new section on Introduced Business has been drafted and can be found at paragraph 9 of the Code. The paragraph significantly limits the circumstances in which a relevant person in the IOM can rely on CDD information and evidence which is presented by a third party. It particularly limits where that third party has collected information from another party and an information chain has been established.

¹ Items 'laid before' are taken as approved unless a Member of Tynwald moves a motion otherwise.

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- 2.4 Paragraph 9(3) requires that if a customer is introduced to a relevant person who provides elements of CDD, the relevant person must conduct a risk assessment which conforms to the requirements of paragraph 6 of the Code. Paragraph 6 stipulates the risk factors which must be considered before the take-on of any customer.
- 2.5 Paragraph 9(4) of the Code adds additional elements in that the risk assessment must include as a factor for consideration whether introduced business is involved. The relevant person is required to additionally assess the introducer and whether the introducer has met the customer. The risk assessment must also consider whether any parts of the CDD have been directly received from the customer by the introducer, or whether they have been obtained from any third parties. If the latter applies then the relevant person is obliged to establish how many third parties were involved; who they were; whether they met the customer; whether any of the third parties are "Trusted persons" as defined at paragraph 3 of the Code and finally, if any of the third parties are located in a country which the IOM government has deemed to have an AML/CFT regime of equivalent standard to the IOM.
- 2.6 Paragraph 9(5) of the Code obliges the relevant person to take enhanced CDD measures, including establishing the source of wealth of the customer and any beneficial owner, if the risk assessment identifies the customer or the arrangement as high risk.
- 2.7 This risk-based approach is underpinned by an absolute requirement at paragraph 6. Here it is required that in all cases where it is identified that more than one third party is involved in the arrangement of providing CDD information or evidence, the relevant person must verify the identity of the customer using documents, data or information obtained directly from one of three sources. The sources being:-
- a) the customer themselves; or
 - b) the introducer, but only if they have obtained the material directly from the customer or a third party who has met the customer; or
 - c) directly from a third party who has met the customer.

This requirement prohibits any future reliance on information chains by the relevant person who, if they detect such a chain, must bypass its component links and obtain the information, data and documents directly from someone who has met the customer.

- 2.8 Paragraphs 9(8) and (9) ensure the quality of the information, data and documents obtained for CDD purposes in this manner and require that if the identity of the customer cannot be properly identified, the relationship or transaction cannot be allowed to proceed. In these circumstances the relevant person is obliged to consider the making of an STR/SAR.
- 2.9 The new requirements will mean that the relevant person will no longer be able to rely upon CDD information, data and documents if a number of third parties have passed the CDD along to the introducer. Only one 'link' in the chain will be allowed before the relevant person must obtain the CDD material directly from the customer or someone who has directly met the customer. Even when one third party is involved the requirements relating to the risk based approach could mean that enhanced due diligence is required.

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- 2.10 The IOM authorities consider that the new requirements which will be in force from the 1st June 2019, fully meet the recommendation made in the MER in that the measures “further limit the circumstances in which CDD information and evidence of identity presented by a third party can be used” thereby addressing the concerns identified relating to introduced business and the reliance on chains of information.

IMMEDIATE OUTCOME 4

- 3. Authorities should require FIs to take account of risks presented by underlying customers when applying CDD exemptions to intermediary customers under paragraph 21 of the AML/CFT Code. Application of the exemption should also be prohibited where specific higher risk scenarios apply. Requirements to sample-test whether CDD and record-keeping requirements are appropriately applied to underlying third parties should be reviewed and alternative measures put in place, as necessary, to mitigate risk.**

3.1 Paragraph 21 of the AML/CFT Code 2015 referred to above is the paragraph concerning “persons in a regulated sector acting on behalf of a third party.” In the new AML/CFT Code 2019, which will come into operation on 1st June 2019 (as described above), paragraph 21 has now been replaced by paragraph 17.

3.2 The Anti-Money Laundering and Countering the Financing of Terrorism (Amendment) Code 2018 came into operation on 14th September 2018. At paragraph 12 a new paragraph 21 was substituted replacing what was in place at the time of the MER. A copy of the amending 2018 Code is attached at Attachment 5.

3.3 For the sake of this report reference will be made to paragraph 17 in the new AML/CFT Code (Attachment 4) which is about to come into force. Nevertheless MONEYVAL is also referred to paragraph 12 of the Anti-Money Laundering and Countering the Financing of Terrorism (Amendment) Code 2018 at Attachment 5 which is currently in force. The wording between the two paragraphs has been amended slightly for drafting purposes but the requirements remain the same.

3.4 In answer to the requirement that Authorities should require FIs to take account of risks presented by underlying customers when applying CDD exemptions to intermediary customers; and that the application of the exemption should also be prohibited where specific higher risk scenarios apply, a number of requirements have been introduced.

3.5 At paragraph 17(2)(d) of the Code the regulated person is now required to determine that the customer has carried out a comprehensive risk assessment of its underlying clients and has declared to the regulated person that none of those underlying clients pose a higher risk. Paragraph 17(2)(i) requires that the regulated person must also determine that the customer themselves does not pose a high risk of ML/FT.

3.6 Paragraph 17(3)(c) stipulates that the terms of business which must be in place between the regulated person and the customer, require the customer to confirm to the regulated person that he has no underlying client in the arrangement who has been assessed as high risk.

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- 3.7 The IOM authorities consider that these additional requirements, which were added in 2018 and which have been reiterated in the new Code which is soon to be in force, require the regulated person to fully take account of risk in this area. Application of the exemption is also prohibited under paragraph 17(2) as the exemption cannot be applied unless all the conditions listed are met. This includes 17(2)(i) regarding the customer posing a higher risk of ML/FT.
- 3.8 The requirement to sample test, at least every twelve months, that the customer can comply with the requirements of paragraph 17 still applies and can be found at paragraph 17(5)(a). This includes verifying that the requirements relating to CDD and record keeping in relation to the underlying clients are being met. However a further requirement has also been added.
- 3.9 At paragraph 17(2)(b) it is now a requirement that the exemption can only be used if;
- “the regulated person is satisfied the customer is regulated and supervised, or monitored for and has measures in place for compliance with, customer due diligence and record keeping requirements in line with FATF Recommendation 10 (Customer Due Diligence) and 11 (Record Keeping).”*
- Therefore, before the exemption can be used, it is a precondition that the regulated person must verify that the customer is correctly applying CDD and record keeping measures equivalent to international standards.
- 3.10 The IOM authorities consider that the additional requirements added to paragraph 21 in 2018 and reiterated at paragraph 17 of the new 2019 Code fully meet the recommended action at IO4 as described at 3 above.

Conclusion

The 57th MONEYVAL Plenary agreed that the IOM should enter the CEPs procedure in order that three specific matters identified as outstanding from the 2016 MER should be monitored, with a view to their being addressed in a timely manner.

The IOM took action on IO4 ‘application of CDD exemptions’ in September 2018 and has since reiterated that action within the new 2019 Anti- Money Laundering Code. The 2019 Code, which has been drafted, fully consulted upon and will be in force on 1 June 2019, meets the recommended action in the MER by limiting evidence of CDD information and identity provided by a third party. The IOM will immediately notify MONEYVAL after the sitting of Tynwald on 21 May 2019 when the 2019 Code has the final approval to come into force and effect. This will be in compliance with paragraph 7 of Rule 27 in MONEYVAL’s Rules of Procedure for the 5th Round of Mutual Evaluations.

Finally, under IO3, the IOMFSA has been demonstrating use of their powers to sanction as appropriate in severe cases and the authorities have ensured that the IOMFSA has the required suite of powers, including civil penalties, to deter and to sanction industry as and when such action is called for.

On the basis of the above actions which have been introduced by the IOM, it is requested that the July 2019 MONEYVAL Plenary give consideration to removing the IOM from the CEPs process.

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Cabinet Office, Isle of Man Government

15 May 2019