
Financial Supervision Commission Conduct of Business Regulatory Code

Government Circular Numbers: 400/91 and 99/92

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FINANCIAL SUPERVISION COMMISSION

CONDUCT OF BUSINESS

REGULATORY CODE

The following Code is issued by the Financial Supervision Commission in exercise of the powers conferred on it by Section 6 of the Investment Business Act 1991, and all other powers enabling it in that behalf. All correspondence relating to this Code should be addressed initially to the Financial Supervision Commission.

Adopted by Financial Supervision Commission on 14 November 1991, with amendments adopted on 13 February 1992, 27 March 1996, 31 March 1999 and 1 August 2000

Approved by Tynwald on 10 December 1991, 17 March 1992, 21 May 1996, 20 April 1999 and 19 October 2000

Price: £1.40

1. CITATION, COMMENCEMENT, INTERPRETATION AND APPLICATION

1.1 Citation and Commencement

This Code may be cited as the "Financial Supervision Commission (Conduct of Business) Regulatory Code" and shall come into operation on 1st December 1991.

1.2 Interpretation

A Guidance Note appended to a paragraph gives guidance as to how the Commission considers it would operate in particular circumstances. It is not part of the Code.

The Interpretation Act 1976 applies to the interpretation of this Code and, unless the context otherwise requires, expressions defined therein have the same meanings when used in this Code.

The glossary contained in the Financial Supervision Commission (General Requirements) Regulatory Code applies to the interpretation of this Code.

The objectives of this Code are to ensure that a person authorised to carry on investment business:-

- a) acts with high standards of integrity and fair dealing in the conduct of investment business and complies with best market practice; and
- b) acts with due skill, care and diligence in providing any service which he provides or holds himself out as willing to provide; and
- c) deals fairly with his clients in any transaction entered into or arranges to be entered into with them on their behalf;

and, accordingly, this Code shall be interpreted in the light of these objectives so as best to give effect thereto.

1.3 Additional Interpretation

- a) A client will be deemed to be a "**private investor**" unless he has specifically elected in writing not to be.
- b) "**Execution-only client**" means, in relation to the effecting of a transaction by a licenceholder, a client with or for whom that transaction is effected in circumstances in which the licenceholder can reasonably assume that the client is not relying upon the licenceholder to advise him on or to exercise any judgement on his behalf as to the merits of or the suitability for him of that transaction.

Guidance Note

For the avoidance of doubt licenceholders should confirm "execution - only" status in writing, pointing out the consequent reduction of investor protection.

1.4 **Application**

This Code applies to all holders of investment business licences issued under Section 3 of the Investment Business Act 1991, [with the exception of holders of Category 5 investment business licences.]

2. **INTEGRITY AND FAIR DEALING**

2.1 **Integrity and fair dealing**

A licenceholder should observe high standards of integrity and fair dealing in the conduct of its investment business and should avoid conflicts of interest.

2.2 **High standards of market conduct**

A licenceholder should comply with high standards of market conduct including compliance with statute law and any Code or standard (which applies to the licenceholder) which has been issued or endorsed by any investment exchange where investment business is conducted or by the Commission. (See also Code 6.3).

2.3 **Informed investment decisions**

A licenceholder should take all reasonable steps to enable clients to take informed investment decisions and should avoid misleading or deceptive representations or practices. (See also Code 4.1).

2.4 **Independence**

A licenceholder should not claim that it is independent or impartial if it is not and it should ensure that any claim it makes as to its independence or impartiality

[] added by SD 155/96

adequately includes any limitation which there may be on either.

A licenceholder should not represent itself as acting independently if it has any relationship or arrangement with any other person which:-

- a) brings any distortion into the way in which it conducts its business with a client; or
- b) results in an advantage to the licenceholder, or a disadvantage to the client, in any business done with him.

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2.5 Inducements

A licenceholder should not (and should not permit anyone acting for it to) offer or receive gifts or other direct or indirect benefits, including "**volume overrides**", if doing so could adversely influence the giving of advice or the exercise of discretion.

2.6 Unreasonable recommendations

A licenceholder should not recommend to a private investor a transaction if the recommendation is motivated largely by the benefits which it may bring to the licenceholder, unless the transaction is demonstrably to the investor's advantage.

2.7 Churning

A licenceholder should not effect transactions with unnecessary frequency or in excessive size with or for a client for whom the licenceholder exercises discretion as to how the client's funds are invested.

2.8 Overcharging

A licenceholder's charges should not be unfair in their incidence or unreasonable in their amount. They should be directly related to the circumstances and nature of the services being provided and the disclosed relationship between the licenceholder and the client. (See also Code 5.5(b)).

2.9 Valuation of investments which are not marketable

Where a licenceholder is a portfolio manager and the amount of any remuneration of the licenceholder is dependent upon the value of the assets in the portfolio, the

valuation of those assets which are not readily marketable or for which information for determining their current value may not be available should be on the basis of an arm's length valuation which:-

- a) has been prepared by; or
- b) confirmed as an arm's length valuation by an independent and competent person; or
- c) agreed expressly with the client at the time that the discretionary management agreement is signed (see also Code 5.5(b)).

2.10 Front running

A licenceholder, or any party related to it, should not enter into an investment transaction ahead of a client, if that client ought to have priority.

2.11 Fairness in allocation

Where there is not enough stock or other investments to go around, the licenceholder should always allocate what it has fairly and uniformly, and it should put itself last unless its participation in the deal enabled everyone to get a better deal.

2.12 Distribution of transactions among clients

A licenceholder should not allocate or transfer to any client any deal (or part of a deal) in an investment which it entered into as principal unless allocation or transfer was unconditionally decided upon in principle before the deal was done, or the investment has improved in value since the deal and the licenceholder is satisfied that the investment is suitable for the client and the client obtains the benefit of best execution and of the improvement in value.

2.13 Fairness with research or analysis

A licenceholder should not: -

- a) deal for itself or a connected client ahead of the distribution of its own or its associate's research or analysis and with advance knowledge of anything that might possibly be price sensitive in it; or
- b) distribute research or analysis containing recommendations from which a licenceholder expects to benefit (for example by way of past or future principal transactions or because of a material interest) unless the anticipated source of benefit is disclosed; or
- c) otherwise behave unfairly in the way in which it acts upon its research or analysis.

2.14 Conflicts of Interest

A licenceholder should avoid conflicts of interest arising or, if conflicts arise, should ensure fair treatment to all its clients, by way of disclosure, internal rules or procedures or otherwise.

- a) Where a reasonable and properly informed client would expect that the licenceholder would place his interests above its own, the licenceholder should live up to that expectation.
- b) A licenceholder should not undertake or recommend an investment transaction in which it has a material interest without the prior knowledge of the client.

Disclosure of all conflicts of interest is both fair to the client and necessary if he is to make informed investment decisions. (See also Codes 2.3 and 4.5).

3. SKILL, CARE AND DILIGENCE

3.1 Skill, care and diligence

A licenceholder should act with due skill, care and diligence in the conduct of investment business.

3.2 Prompt and timely execution

A licenceholder should act promptly in accordance with its instructions, unless it has been given a discretion as to timing and it uses that discretion in an alert and sensible way. Instructions and decisions to buy or sell should be recorded as soon as taken, with the date and, whenever possible, the time.

3.3 Best execution

A licenceholder should not transact business for a client on worse terms than it would expect to obtain for itself, making allowances for the size of the transaction, except that where a licenceholder effects a transaction through another permitted person, or a person authorised under the UK Financial Services Act 1986 it may rely upon that person to obtain best execution provided that the person has accepted such arrangements in writing.

3.4 Knowledge of Client

Other than execution-only clients, a licenceholder should find out enough about a **private investor's** personal and financial circumstances to enable it to act properly for him in investment matters.

3.5 Suitability

In making recommendations to a client, in exercising discretion, and in advising about the client's instructions, a licenceholder should ensure as far as it can, having taken reasonable steps to inform itself of what is available on the market, that purchases and sales are not unsuitable for any client and that they are positively suitable for him if he is a **private investor**.

Life Policies and Collective Investment Schemes. A licenceholder should not recommend to any client the acquisition of a life policy or units in a collective investment scheme, nor should it effect on behalf of a client a transaction or acquisition of that kind unless it is satisfied that the acquisition will be suitable for the client and that the recommended product does not compare unfavourably with competing products.

Switching. A licenceholder should not recommend or effect a switch of life policies or units in a collective investment scheme unless the licenceholder reasonably believes that the switch will be to the client's advantage and can demonstrate to the Commission, if required, the basis of this belief.

3.6 **Disrepute**

The nature and conduct of a licenceholder's business should not be such as may in the opinion of the Commission bring the Isle of Man into disrepute or damage its standing as a financial centre.

3.7 **Manager of collective investment schemes to observe the terms of scheme particulars.**

A licenceholder which is the manager of an authorised or [international] collective investment scheme within the meaning of the Financial Supervision Act 1988 should take all reasonable steps to comply with every statement in the most recently published prospectus, explanatory memorandum or other documentation describing how he will operate the scheme and will comply with the duties imposed on him by or under the Financial Supervision Act 1988.

3.8 **Collective Investment Schemes: forecasts of future income**

A licenceholder's prediction or forecast of future income from a collective investment scheme operated by him should be based on and consistent with present conditions and it should be able to justify the forecast to the Commission if required to do so.

3.9 **Polarisation: restriction on authority conferred by product companies**

A licenceholder should prohibit by the terms of employment or contract its employees and tied agents who are authorised to canvass for business from canvassing for or advising about life policies or collective investment schemes other than its own.

4. **DISCLOSURE AND INFORMATION**

4.1 **Disclosure and information**

A licenceholder should take all reasonable steps to ensure that a **private investor** is given sufficient information which he is able to understand to enable him to make balanced and informed investment decisions.

4.2 **Disclosure of regulator**

A licenceholder should ensure that the identity of its regulator is disclosed in all correspondence, advertisements, and other documents.

Guidance Note

The following wording is suggested:-

"Licensed to conduct Investment Business by the Isle of Man Government Financial Supervision Commission".

[] amended by SD 410/00

4.3 Information to be supplied by tied agents.

- a) A licenceholder who is a tied agent should ensure that a private investor to whom it provides services is adequately informed in all communications about its identity and its relationship with the product company.
- b) A licenceholder which is the Manager of an authorised or [international] collective investment scheme within the meaning of the Financial Supervision Act should ensure that its tied agents comply with this Code.

4.4 Life policies and Collective Investment Schemes: disclosure of product particulars.

A licenceholder should ensure that before or immediately after a recommendation is made to take out a life policy or buy units in a collective investment scheme, a **private investor** is given or sent a statement, prepared by the recommender or by the product company, which informs him of details of the product, which should include premiums or other amounts payable then and in the future, the factors relevant to the ultimate value of the investment (or benefits payable under it), the consequences of not keeping up the payments, and any surrender or transfer value.

Guidance Note

This Code does not apply where a licenceholder is acting under the terms of a discretionary management agreement.

4.5 Disclosure of conflicts of interest

Where conflicts of interest between a licenceholder and its client are unavoidable the licenceholder should disclose them fully to the client. (See also Code 2.14).

4.6 Disclosure of links with an associate.

A licenceholder should not advise a client to use the services of another person who is an associate of the licenceholder without disclosing that relationship.

4.7 Disclosure of remuneration and commissions.

Before a licenceholder undertakes investment transactions for or advises a client, it should inform him, unless he has specifically agreed that this is unnecessary, of all relevant facts relating to its remuneration (including the remuneration of any intermediary which is payable by the client) attributable to the transaction or advice.

4.8 Understanding of risk.

A licenceholder must not recommend a transaction to a **private investor**, or act as a discretionary manager for him, unless it has taken reasonable steps to enable the investor to understand the nature of the risks involved.

In particular, where the client is a **private investor**, a licenceholder should not -

- (i) advise him to deal or deal with or for him in futures or options or contracts for differences, unless it has arranged for the client to receive (and the client has, by returning a signed copy, shown that he has understood) a risk disclosure statement which should contain the elements set out in the form specified in Appendix A; or
- (ii) advise him to buy or effect in the exercise of discretion any purchase of an illiquid investment or one which is not readily realisable, unless it has informed the client of the nature and extent of the risks involved in such investments, including any difficulties in determining their value, and has obtained his written consent.

4.9 Periodic Information

A licenceholder which is managing a portfolio for a client should normally account to him at least once in every six months as to the investment performance of the portfolio, stating the current valuations, a suitable comparison with the movement of the market, and any changes in composition of the portfolio. The client may expressly waive the requirement for a biannual report in favour of an annual report, but before reaching such an agreement with a client, the licenceholder should make the client aware that he is entitled to receive information every six months.

4.10 Introductions to unauthorised persons or overseas branches

A licenceholder who introduces a **private investor** to an investment business which is outside the Isle of Man should disclose to the investor that such business will not be covered by the Investment Business Act 1991 and should inform the client of the system of regulation pertaining to investment business in that jurisdiction.

5. ACTING WITH AGREEMENT

5.1 General Need for a Client Agreement

Subject to Codes 5.2 and 5.3 a licenceholder which conducts investment business with any client should do so by means of a written agreement which should set out the basis on which its services are to be provided. The agreement should be easy to understand, not likely to be misunderstood and conform with this Code. The agreement should not remove from the client any rights which he would have had if the agreement had not existed. Unless the agreement specifies to the contrary, the client will be deemed to be a **private investor** and, if not, the client should be informed in writing that the level of protection afforded to him is lower than that offered to a **private investor**.

5.2 Exceptions

No client agreement is required for:-

- a) the issue of any tipsheet, broker's circular or other investment publication;
- b) a contract by the operator of a collective investment scheme as principal to sell or purchase units in that scheme;
- c) advising on and arranging transactions (not involving any element of discretionary management by the adviser or arranger) which are limited to life policies or units in collective investment schemes where the client's requirements are reasonably believed by the licenceholder to be confined to that area of activity.
- d) deals effected or arranged on behalf of an execution-only client.

In the case of (b) and (c) above, if the licenceholder receives Clients' Money (eg cash, or cheques which are made payable to the licenceholder rather than a life company or scheme manager), a separate agreement should be entered into with the client detailing the arrangements for handling clients' money, specifying how the money will at all times be separated from the licenceholder's own money and stating the arrangements for crediting interest to the clients' account.

5.3 Dealing while negotiating etc

Deals not involving undue risk may be made on behalf of clients whilst negotiations leading to a client agreement are taking place; and deals may be made after an agreement has expired or been brought to an end solely to complete outstanding obligations.

5.4 Penalty on termination

Where the client is a **private investor**, the client agreement may provide for an additional payment to be made to the licenceholder upon the termination of the agreement but this must be clearly disclosed in the client agreement.

5.5 Standard Client Agreement

The standard agreement with **private investors** should normally include statements on:-

- (a) the nature of the services to be provided by the licenceholder under it, including, where appropriate, the client's investment objectives and any restrictions on investments or markets in which funds may be invested;
- (b) in respect of any fees payable by the client to the licenceholder:-
 - i) the basis of calculation. In this regard the licenceholder should give clients at least one month's notice of any proposed fee increase;

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- ii) the basis of payment (deduction or billing etc). In this regard the licenceholder should make no deduction from income or capital belonging to a client in respect of its fees unless it has given notice to the client. The procedure for doing this should be specified in the agreement;
 - iii) the frequency of payment; and
 - iv) whether or not any fees payable are to supplement or be abated by any remuneration receivable by the licenceholder in connection with transactions effected by the licenceholder with or for the client;
- (c) the fact that the licenceholder is regulated in the conduct of its investment business by the Commission (see also Code 4.2);
 - (d) the manner in which the instructions may be given by the client for any transaction;
 - (e) the arrangements for handling and accounting for client money, specifying how the money is at all times separated from the licenceholder's money and stating arrangements for crediting interest to the client account. (See also the Financial Supervision Commission (Clients' Money) Regulatory Code);
 - (f) the arrangements for registration and identification of ownership and safe custody of documents of title and the name of any nominee company used. (See also the Financial Supervision Commission (Clients' Investments) Regulatory Code);
 - (g) the clients' rights of inspection of copy contract notes, vouchers and copies of entries in books or electronic recording media relating to the clients' transactions together with a statement that such records will be maintained for 6 years from the date of the transaction;
 - (h) arrangements for bringing the agreement to an end which should confer the right for the investor to terminate the agreement on immediate written notice.

Where a licenceholder is effecting margined transactions on behalf of a **private investor**, the agreement should include:-

- (i) a warning that the licenceholder in certain circumstances may be required to obtain additional money from the client by way of margin. (See Code 7.3);
- (j) where the licenceholder intends to effect contracts which are not traded on and under a recognised or designated exchange, this should be specified in order that authority may be granted by the client;
- (k) a statement of when a deposit or margin (including the initial and variation margin) may be required and the licenceholder's rights on failure to pay; also a warning that failure to meet margin calls may lead to closing out without reference. (It may also include arrangements under which the licenceholder lends money to the client to meet margin calls);

- (l) a statement of the circumstances in which it might be possible for a licenceholder to close out without reference to the client.

5.6 Discretionary portfolio management agreement

Where a licenceholder is to exercise discretion for a **private investor** in the management of his investments a greater degree of trust is involved. Hence, in addition to items contained in Code 5.5 (the standard client agreement), the licenceholder should include statements specifying the following:-

- (i) whether or not there is any restriction on the categories of investment in which the fund comprised in the portfolio may be invested or on the amount or on the proportion of the fund which may be invested in any category of investment or in any one investment and, if so, what those restrictions are;
- (ii) the frequency with which the client is to be supplied with a statement of the money and the investments comprised in the portfolio and a valuation thereof and what the basis of valuation is to be;
- (iii) if the agreement is to include a measure of portfolio performance then the basis on which that performance is to be measured;
- (iv) whether hedging or borrowing powers are to be used, the nature of such powers and limits upon their use. (See also Code 5.7);
- (v) whether the manager is to have powers to lend securities to or borrow securities from third parties or to charge securities to secure borrowings, how such powers are to be exercised and the limits placed upon them.

A statement showing the initial composition of the portfolio, and its initial value (so far as it can be ascertained) should be provided to the client at the time that the client agreement is signed or as soon as practicable thereafter.

5.7 Special Provisions in Discretionary Portfolio Management Agreements

Where investment is contemplated in areas involving higher risk investments on behalf of a **private investor**, the agreement should specifically state whether such transactions are permitted and any limits on the category of investment or on the financial commitment involved. It should also contain the required risk warnings (See Code 4.8 and, suitably modified, (j) (k) and (l) in Code 5.5 above).

Examples of such higher risk investments are:-

- (a) writing of options and doing business in futures and contracts for differences;
- (b) other margined transactions;

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- (c) illiquid investments; and
- (d) participation in underwriting securities.

5.8 The licenceholder should comply with the terms of the relevant client agreement in all dealings with or on behalf of clients.

6. RESPONSIBLE CONDUCT

[6.1 Responsible Conduct / Anti-Money Laundering

A licenceholder should organise and control its internal affairs in a responsible manner and ensure that it has well defined procedures to facilitate compliance with the regulatory requirements.

In particular, a licenceholder shall have adequate policies and procedures in place, including strict "Know Your Customer" rules, that promote high ethical standards in the financial sector and prevent the business being used, intentionally or unintentionally, by criminal elements. These policies and procedures shall ensure compliance with the money laundering legislation in force at that time.

Where the licenceholder employs staff or is responsible for the conduct of investment business by others, it should have adequate arrangements to ensure that such people are suitable, adequately trained and properly supervised.]

6.2 Business Plan

A licenceholder should operate in accordance with its business plan as notified to the Commission from time to time. (See also the Financial Supervision Commission (General Requirements) Regulatory Code 7.5).

[] added by SD 90/99

6.3 Compliance with non-statutory obligations

A licenceholder should regard itself as expected to observe the tenets of any Code or set of standards promulgated by any authority other than the Commission having responsibility in the public interest for the supervision or regulation of investment business or other financial services.

Accordingly, unless it can show any good reason for disregarding any such tenet, (such as inconsistency between it and any applicable provision of this Code or any other legal requirement) a licenceholder should normally comply with it as part of its policy of observing good market practice. (See also Code 2.2).

6.4 Responsible behaviour in dealings by officers and employees

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A licenceholder should have procedures for ensuring that any business done by its officers and employees including tied agents (and those employed by them):-

- a) is openly done (in that, for example, the officer or employee gets consent before dealing, or informs the licenceholder afterwards, wherever appropriate, and reveals his status to other investment businesses before dealing with or through them);
- b) is fairly done (for example that the officer or employee does not deal if a deal by the licenceholder would be in breach of this Code);
- c) is done in compliance with any rules and regulations relating to investment business in other jurisdictions as far as that can reasonably be ascertained;
- d) avoids any conflict of interest which is known to the officer or employee (whether with a client of the licenceholder or with any business carried on by the licenceholder); and
- e) avoids any undisclosed private benefit to the officer or employee (for example by his obtaining credit or special dealing facilities without telling the licenceholder).

The officers, employees and tied agents of the licenceholder should be made aware of the above requirements. (See also Code 6.7).

6.5 Responsible behaviour on the telephone or on visits

Licenceholders should have procedures for requiring those seeking to obtain business to be civil and considerate, not to use any undue pressure, deception or artificiality, to make plain their purpose and identity to clients and potential clients.

6.6 Supervision

A licenceholder should establish procedures to ensure the adequate supervision of staff and tied agents who should not be allowed or required to get out of their depth in terms of their experience and competence. Appropriate records relating to the training, experience and qualifications of staff and tied agents should be maintained, showing the categories of transaction which the person is competent to conduct.

6.7 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.

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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.

6.8 Internal Complaints Procedure

A licenceholder should ensure that complaints from clients are properly handled and that any remedial action needed is promptly taken. A record of the details of the complaint, the licenceholder's response and any action taken as a result, should also be made and maintained.

6.9 Disciplinary action

A record shall be maintained of the names of any employees disciplined by a licenceholder in connection with any breach of this Code or for any other conduct which may reasonably be expected to affect the conduct of the licenceholder's investment business and of the particulars of:-

- (a) the offence for which the employee was disciplined; and
- (b) the steps taken to discipline the employee.

6.10 Provision for cessation of business

A licenceholder should make provision for the protection of its clients in the event of the cessation of the whole or any part of its investment business as notified to and accepted by the Commission.

7. FUTURES, OPTIONS AND CONTRACTS FOR DIFFERENCES

7.1 Risk Warning

A licenceholder should ensure, before it enters into any transaction in futures, options and contracts for differences with or for a private investor that the investor receives, signs and returns to the licenceholder a risk disclosure statement which should contain the elements set out in the form specified in Appendix A. However, this does not apply if the transaction is effected by the licenceholder as a discretionary portfolio manager for a client in accordance with provisions agreed between them. (See Codes 5.5, 5.6 and 5.7).

7.2 Contracts to be on-exchange

A margined transaction on behalf of a client should only be undertaken through an intermediate broker if that person is either:-

- a) another licenceholder permitted to conduct such activity; or

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- b) a person carrying on investment business outside the Isle of Man who is required to hold clients' money received in relation to margined transactions in a segregated bank account for that purpose and in his books to credit the client accordingly.

The licenceholder should take steps to ensure that clients' money is treated as clients' money by the intermediate broker or Exchange.

Except with the express permission of the client, (see Code 5.5(j)) no licenceholder may effect a margined transaction for a private investor in contracts other than those traded on a recognised or designated exchange.

7.3 **Liability in respect of margins**

A licenceholder should keep daily track of the amount of margin or other requirements which should be paid for each client and should ensure that any margin payable is required to be deposited in advance in cash or approved collateral, that any deposit on a limited liability transaction is deposited promptly and in cash, and that margin whenever properly required to be paid is deposited in cash or approved collateral. The client must be made aware of the consequences of not paying a margin. Where a licenceholder is effecting margined transactions as an investment manager, it must take steps to clarify with the Exchange or intermediate broker whether or not the licenceholder is responsible for the fulfilment of its clients' obligations. (See also the Financial Supervision Commission (Clients' Money) Regulatory Code 8.2 and the Financial Supervision Commission (Conduct of Business) Regulatory Code 5.5(k)). If there is a shortfall, the relevant licenceholder should make up the difference until it obtains more cash or collateral from the relevant segregated client. (See also the Financial Supervision Commission (Clients' Money) Regulatory Code 4.3). If the licenceholder is proposing to lend money to its client for this purpose, its accounting methods should be adequate to ensure proper records.

8. **DOCUMENTATION AND RECORDS**

8.1 **Contract Note etc**

After a transaction has been carried out for a client, the licenceholder should send, or arrange for there to be sent, to the client or to his order promptly a note of the essential features of the transaction (unless the licenceholder reasonably believes that another investment business or product company will send to the client such a note).

8.2 **Exceptions**

No statement is required where:-

- (i) the transaction is effected with a market counterparty (though there may be other obligations by contract or custom);
- (ii) the transaction relates to a life policy; or

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- (iii) the client has made a specific written request, duly signed, separate from all other agreements, that contract notes should not be sent to him/her and has not subsequently revoked this request.

No immediate statement is required where the transaction is:-

- a) part of a series of linked transactions such as a savings plan or similar arrangement entered into by the client with the licenceholder, e.g., for the purchase of units in a collective investment scheme. In such circumstances, a statement should be sent on completion of the series or at appropriate intervals not longer than three months apart;
- b) where a transaction involves a third party who has failed to provide information required of him; or
- c) where a transaction involves the conversion of one currency into another and that conversion has not been made.

In these and similar circumstances the statement should be sent as soon as practicable.

8.3 Contents of contract notes, confirmation notes, difference accounts etc

The statement required by Code 8.1 should specify the essential features of the transaction including:-

- a) the name and address of the licenceholder;
- b) the client's designation and account number;
- c) the date of the transaction;
- d) description of the investment and size of transaction;
- e) the nature of the transaction and unit price (and whether forward or historic price);
- f) total cost;
- g) amount of remuneration of the licenceholder. (Where the transaction relates to units in a collective investment scheme, the amount of any front end loading should be expressed either in cash terms or as a percentage of the unit price);

Guidance Note

The term "front end loading" means a situation where deductions for charges and expenses are not made uniformly throughout the life of an investment but are loaded disproportionately on the early years.

- h) amount of fees, taxes or duties;

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- i) settlement date;
- j) if the transaction involves converting one currency into another, the relevant exchange rate.

Upon exercise of an option, the following items should be included in the statement:-

- (k) the profit or loss to the client arising out of the exercise of the option; and
- (l) the fees, commissions and expenses payable by the client, if any, in connection with the transaction.

8.4 General Records

- 8.4.1 A licenceholder must establish and maintain procedures to ensure that sufficient information is recorded and retained about the conduct of its business and its compliance with any licence conditions, Codes and regulations imposed upon it under the Investment Business Act 1991. (See also Code 6.7 and the Financial Supervision Commission (Audit Requirements) Regulatory Code 4.3).
- 8.4.2 Every licenceholder shall establish and maintain adequate systems and controls over its accounting records, having regard to its size and the nature and complexity of its activities.
- 8.4.3 The systems and controls must be such as to enable the licenceholder to discharge properly the duties imposed upon it by or under the applicable Codes, licence conditions or regulations. Systems and controls shall not be treated as established or maintained unless they are adequately and correctly documented.

8.5 Accounting Records - Clients' Records

- 8.5.1 Every licenceholder shall keep and maintain proper accounting records to show and explain transactions effected by the licenceholder on behalf of its clients.

Guidance Note

These records relate to all the assets and liabilities (including cash) that the licenceholder is responsible for managing, administering, or controlling on behalf of the client. These records cover not only those assets in the possession of the licenceholder, but also money that the licenceholder has power to spend e.g. as signatory to a third party account and may include records of a client's investment portfolio even though the investment certificates are not held or controlled by the licenceholder.

- 8.5.2 Such records shall:-
 - a) be kept in English;
 - b) be kept up to date; and
 - c) be in such a form as to demonstrate compliance with this Code.

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8.5.3 Such records shall:-

- a) disclose with reasonable accuracy, at any time, the assets, liabilities and details of transactions of the licenceholder's clients, both individually by client and collectively, to the extent that they are controlled by or effected by the licenceholder;
- b) contain such information as is necessary to enable the licenceholder to prepare statements of each client's assets and liabilities and details of each client's transactions in each case to the extent that they are controlled or effected by the licenceholder; and
- c) identify which assets the licenceholder, or his eligible custodian, are responsible for as a custodian.

8.5.4 The accounting records shall in particular contain:-

- a) entries from day to day of all purchases and sales of assets by the licenceholder acting for a client;
- b) a record of all income and expenses, explaining their nature;
- c) entries from day to day of all receipts and payments of Clients' Money, including interest if applicable;
- d) an up-to-date record of the balances on all Client Bank Accounts and all other Clients' Money accounts at third parties and a record of the clients to whom these monies belong;
- e) records to demonstrate compliance with the Financial Supervision Commission (Clients' Money) Regulatory Code;
- f) records to demonstrate compliance with the reconciliation requirements of the Financial Supervision Commission (Clients' Money) Regulatory Code and Financial Supervision Commission (Clients' Investments) Regulatory Code;
- g) records necessary to identify the nature, amount, nominal value and location of each Client's Title Document, whether it is held by the licenceholder or by an eligible custodian. In addition, if an eligible custodian is used, the licenceholder is responsible for ensuring that such records are maintained by the custodian; and
- h) entries which record the date at which the Client's Title Documents came into or left the possession or control of the licenceholder.

8.5.5 The accounting records shall in particular contain records to demonstrate compliance with this Code, in particular Codes 2.6, 2.9, 2.11, 2.12, 3.2, 3.4, 3.5, 4.8, 5.1, 6.7, 6.8, 6.9, 8.1.

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8.5.6 Inspection of records

- a) A licenceholder must allow each of its clients during business hours to inspect, either personally or by his agent, any entry in a record kept by it of matters relating exclusively to him as soon as practicable and, in any event, not more than fourteen days after it receives a request from him to carry out such an inspection.
- b) If a licenceholder's client asks to inspect any entries in its records which relate to transactions effected by the licenceholder with or for him, but which are not exclusive to him, the licenceholder must, if it refuses to comply with the request, inform the client that the Commission has the right to inspect those entries.

8.6 Retention of Records

A licenceholder shall keep:-

- (a) the records which it is required by this Code and all other Codes to make;
- (b) copies of contract notes which it is required to provide under Code 8.1; and
- (c) any working papers which are created to assist in the preparation of the financial statements required to be prepared under the Financial Supervision Commission (Financial Resources and Reporting) Regulatory Code.

for a period of six years after the date on which they are made or prepared and during the first two of those years they shall either be kept at a place where the licenceholder carries on business or in such manner that they can be produced at such a place within twenty-four hours of demand.

8.7 Records kept by third parties

The licenceholder may accept and rely on records supplied by a third party so long as those records are capable of being and are reconciled with records created by the licenceholder.

[Revised Appendix Inserted by SD 90/99]

APPENDIX A

(See Codes 4.8 and 7.1)

RISK DISCLOSURE STATEMENT

DERIVATIVES RISK DISCLOSURE STATEMENT

- I. This notice is provided to you as a Private Investor in compliance with the Regulatory Codes issued by the Isle of Man Government Financial Supervision Commission. Private Investors are afforded greater protection under those Codes than those classed as non-private investors, and you should ensure that your Investment Manager tells you what this protection is.
- II. This notice does not disclose all of the risks and other significant aspects of derivatives products such as futures, options and contracts for differences. Nor does it attempt to define all the relevant terms used, and you should ensure that any terms which you do not understand are fully explained to you before completing this Risk Disclosure Statement. **You should not deal in derivatives unless you understand the nature of any such contracts that you may be entering into or which may be entered into on your behalf, and the extent of your exposure to risk. You should also be satisfied that such contracts are suitable for you in the light of your circumstances and financial position.**
- III. Whilst derivatives can in certain circumstances be used for the management of investment risk, some such investments are unsuitable for many investors. Further, strategies intended to reduce risk may be impossible to complete in some market conditions, and so the intended level of protection will not be obtained. You should establish whether this will be a possibility. Your Investment Management Agreement should make it clear whether your Investment Manager may use derivatives on your behalf for speculative purposes, or whether they may only be used to effect an investment strategy of reducing risk.
- IV. Certain strategies using a combination of instruments, such as those described as "spreads" or "straddles", may be as risky as - or more risky than - simple "long" or "short" positions. Investors may not only lose their entire capital, but be liable to pay much more. Different instruments involve different levels of exposure to risk, and in deciding whether to trade such instruments you should be aware of the following points:-
 - A. **Futures**

Transactions in futures involve the obligation to make, or to take, delivery of the underlying asset of the contract at a future date, or in some cases to settle a position with cash. **They carry a high degree of risk.** The "gearing" or "leverage" often obtainable in futures trading means that a small deposit or down-payment can lead to large losses as well as gains. It also means that a relatively small market movement can lead to a proportionately much larger movement in the value of an investment, and this can work against you as well as for you. **Futures transactions carry a contingent liability, and you should be aware of the implications of this, in particular the margining requirements which are set out in paragraph f) below.**

B. Options

There are many different types of options, with different characteristics and subject to different conditions. You should ensure that these characteristics are appropriate to your circumstances; you should also be aware of the relevant **expiry dates**, after which the rights attached to your options can no longer be exercised.

- 1. Buying options:** Buying options involves less risk than writing options, because you can simply allow your option to lapse if the price of the underlying asset moves against you. The maximum loss is limited to the cost of the option (the "premium") you have paid, plus any commission or other transaction charges. However, if you buy a call option on a futures contract, and you later exercise the option, you will acquire the future. This will expose you to the risks described under "Futures" and "Contingent Liability Transactions".
- 2. Writing Options:** If you write an option, the risk involved is considerably greater than that involved in buying options. By writing an option, you accept a legal obligation to purchase or sell the underlying asset if the option is exercised against you, **however far** the market price has moved away from the exercise price. You may be liable for margin to maintain your position, and a loss may be sustained well in excess of any premium received. If you already own the underlying asset which you have contracted to sell (this is known as dealing in "covered call options") the risk is reduced. If you do not own the underlying asset (i.e. you are dealing in "uncovered call options") the risk can be unlimited. **Such transactions are not generally suitable for private investors and so only experienced persons should contemplate writing uncovered options, and then only after securing full details of the applicable conditions and potential risk exposure.**
- 3. Traded options** are options which are traded on an exchange. There is therefore a market in them and this can be helpful in valuing or liquidating ("closing out") positions.
- 4. Traditional Options:** A further type of option known as a "traditional option" is written by certain London Stock Exchange firms under special exchange rules. These may involve greater risk than other options (eg Traded Options above). Two way prices are not usually quoted in them, and there is no exchange market on which to close out an open position or to effect an equal and opposite transaction to reverse an open position. It may be difficult to assess the option's value, or for the seller of such an option to manage his exposure to risk. Certain options markets operate on a margined basis, under which buyers do not pay the full premium on their option at the time they purchase it. In this situation you may subsequently be called upon to pay margin on the option up to the level of your premium. If you fail to do so as required, your position may be closed or liquidated in the same way as a futures position.

C. Contracts for Differences

Futures and options contracts can also be referred to as "Contracts for Differences". These can include options and futures on the FTSE100 index or any other index, as well as currency and interest rate swaps. However, unlike other futures and options, these contracts can only be settled in cash. Investing in a contract for differences carries the same risk as investing in a future or an option and you should be aware of these as set out in paragraphs a) and b) respectively. **Transactions in contracts for differences may also have a contingent liability and you should be aware of the implications of this as set out in paragraph f) below.**

D. Off-exchange Transactions in Derivatives

It may not always be apparent whether or not a particular derivative is effected on or off-exchange. **Your Investment Manager must make it clear to you if you are entering into an off-exchange derivative transaction**, and may only enter into off-exchange transactions which have a contingent liability (see paragraph (6)) with your express permission.

While some off-exchange markets are highly liquid, transactions in off-exchange or "non-transferrable" derivatives may involve greater risk than investing in on-exchange derivatives because there is no exchange market on which to close out an open position. It may not be possible to liquidate an existing position, to assess the value of the position arising from an off-exchange transaction or to assess the exposure to risk. Bid and offer prices need not be quoted, and, even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

E. Foreign Markets

Foreign markets will involve different risks to UK markets. In some cases the risks will be greater and further, timely and accurate information may be harder to obtain. **On request**, your Investment Manager must provide an explanation of the relevant risks and protections (if any) which will operate in any relevant foreign markets, including the extent to which he will accept liability for any default of a foreign broker through whom he deals. The potential for profit or loss from transactions on foreign markets or in foreign currency denominated contracts will be affected by fluctuations in exchange rates, which may more than wipe out any profits made through the underlying investment.

F. Contingent Liability Transactions

Contingent liability transactions which are "margined" require you to make a series of payments against the purchase price, instead of paying the whole purchase price immediately.

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If you trade in futures, contracts for differences or options, you may sustain a total loss of any margin your Investment Manager has deposited on your behalf to establish or maintain a position. If the market moves against you, you may be called upon to pay substantial additional margin at short notice to maintain the position. If you fail to do so within the time required, your position may be liquidated at a loss and you will be liable for any resulting deficit. You should ascertain from your Investment Manager whether he will be liable for any such deficit in the event that he fails to make such payments on your behalf; otherwise, you yourself will be liable.

Even if a transaction is not margined, it may still carry an obligation to make further payments in certain circumstances over and above any amount paid when you entered the contract.

Except in specific circumstances, your Investment Manager may only carry out margined or other contingent liability transactions with or for you if they are traded on or under the rules of a Recognised or Designated Investment Exchange. Contingent liability transactions which are not traded on or under the rules of a Recognised or Designated Investment Exchange may expose you to substantially greater risks.

G. **Collateral**

If you deposit collateral as security, the way in which it will be treated will vary according to the type of transaction involved and where it is traded. There could be significant differences in the treatment of your collateral depending on whether you are trading on a Recognised or Designated Investment Exchange, with the rules of that exchange (and associated clearing house) applying, or traded off-exchange. Deposited collateral may lose its identity as your property once dealings on your behalf are undertaken. Even if your dealings should ultimately prove profitable, you may not get back the same assets that you deposited and you may have to accept payment in cash instead. You should ascertain from your Investment Manager how your collateral will be dealt with.

H. **Commissions**

Before you begin to trade, your Investment Manager should explain to you in writing details of all commissions and other charges for which you will be liable. If any charges are not expressed in money terms (but, for example, as a percentage of the contract value), this should include a clear written explanation, including appropriate examples, to establish what such charges are likely to mean in specific money terms. In the case of futures, when commission is charged as a percentage, it will normally be as a percentage of the **total contract value** and not simply as a percentage of your initial payment.

I. **Suspensions of Trading.**

Under certain trading conditions it may be difficult or impossible to liquidate a position. This may occur, for example, at times of rapid price movement if the price rises or falls in one trading session to such an extent that under the rules of the relevant exchange, trading is suspended or restricted. Placing a "stop-loss" order will not necessarily limit your losses to the intended amounts, because market conditions may make it impossible to execute such an order at the stipulated price.

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J. **Clearing House Protections**

On many exchanges, the performance of a transaction by your Investment Manager (or the third party with whom he is dealing on your behalf) is “guaranteed” by the exchange or its clearing house. However, this guarantee is unlikely in most circumstances to cover you, the Private Investor, and may not protect you if the Investment Manager or another party defaults on its obligations to you. On request, your Investment Manager must explain any protection provided to you under the clearing agreement applicable to any on-exchange derivatives in which you are dealing. There is no clearing house for traditional options, nor normally for off-exchange instruments which are not traded on or under the rules of a Recognised or Designated Investment Exchange.

K. **Insolvency**

Regulations provide for the segregation of Client Money and Clients Investments from the “own funds” of an Investment Manager acting on behalf of clients. Nonetheless, your Investment Manager’s insolvency or default, or that of any broker involved with your transaction, may lead to positions being liquidated or closed out **without your consent**. In certain circumstances, you may not get back the actual assets which you lodged as collateral and you may have to accept any available payment in cash (which may not cover the sum in full). On request, your Investment Manager must provide an explanation of the extent to which he will accept liability for any insolvency of, or default by, any brokers involved with your transactions.

[Name of licenceholder]

[on duplicate for signature by client]

I / we have read and understood the risk disclosure statement set out above. Date-----

Signature----- Signature----- (joint account holders)

[Notes to licenceholders -

1) This statement may be incorporated as part of a two-way customer agreement, except that the customer must sign separately that he has read and understood the risk warnings.

2) Licenceholders may also include further descriptions of the types of investments covered by this statement, provided such descriptions do not lessen the effect of the risk warnings provided.

3) Sub-paragraphs 4a) - g) may be deleted, as appropriate, where they relate to business which will not be carried out with or for the investor/account holder. Paragraphs 1- 4 and sub-paragraphs 4h) - k) are mandatory and may not be deleted.]

WARRANTS RISK DISCLOSURE STATEMENT

- I. This notice is provided to you as a Private Investor in compliance with the Regulatory Codes issued by the Isle of Man Government Financial Supervision Commission. Private Investors are afforded greater protection under those Codes than those classed as non-private investors, and you should ensure that your Investment Manager tells you what this protection is.
- II. This notice does not disclose all of the risks and other significant aspects of warrants; nor does it attempt to define all the relevant terms used, and you should ensure that any terms which you do not understand are fully explained to you before completing this Risk Disclosure Statement. **You should not deal in warrants unless you understand the nature of any transaction that you may enter, or which may be entered into on your behalf, and the extent of your exposure to potential loss.**
- III. **You should also consider carefully whether warrants are suitable for you in the light of your circumstances and financial position.** In deciding whether or not to trade, you should be aware of the following matters :-

A. **Warrants**

A warrant is a right to subscribe for shares, debentures, loan stock or government securities, and is exercisable against the original issuer of the securities. **Warrants often involve a high degree of gearing, so that a relatively small movement in the price of the underlying security results in a disproportionately large movement in the price of the warrant. The prices of warrants can therefore be very volatile.** You also need to take into account the fact that warrants have expiry dates, after which the rights attached to them can no longer be exercised.

You should not buy warrants unless you are prepared to sustain a total loss of the money you have invested plus any commission or other transaction charges.

Some other instruments are also called warrants, but are actually options; for example, a right to acquire securities which is exercisable against someone other than the original issuer of the securities (often called a "covered warrant").

B. **Off-exchange Transactions**

Transactions in off-exchange warrants may involve greater risk than those in exchange-traded warrants because there is no exchange market on which to liquidate your position, to assess the value of the warrant or to assess the exposure to risk. Bid and offer prices need not be quoted, and, even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

Your Investment Manager **must make it clear to you** if you are entering into an off-exchange transaction and advise you of any risks involved.

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C. **Foreign Markets**

Foreign markets will involve different risks to UK markets. In some cases the risks will be greater and further, timely and accurate information may be harder to obtain. **On request**, your Investment Manager must provide an explanation of the relevant risks and protections (if any) which will operate in any relevant foreign markets, including the extent to which he will accept liability for any default of a foreign broker through whom he deals. The potential for profit or loss from transactions on foreign markets or in foreign currency denominated contracts will be affected by fluctuations in exchange rates, which may more than wipe out any profits made through the underlying investment.

D. **Commissions**

Before you begin to trade, your Investment Manager should explain to you in writing details of all commissions and other charges for which you will be liable. If any charges are not expressed in money terms (but, for example, as a percentage of the transaction value), this should include a clear written explanation, including appropriate examples, to establish what such charges are likely to mean in specific money terms.

[Name of licenceholder]

[on duplicate for signature by client]

I / we have read and understood the risk disclosure statement set out above.

Date-----

Signature-----

Signature----- (joint account holders)

[Notes to licenceholders -

- 1) *This notice may be incorporated as part of a two-way customer agreement, except that the customer must sign separately to confirm that he has read and understood the risk warnings.*
- 2) *Licenceholders may also include further descriptions of the types of investments covered by this statement, provided such descriptions do not lessen the effect of the risk warnings provided.]*