

CAROL 5
A further consultation on the Financial Services Rule Book
Financial Resources and Audit Requirements
Summary of Comments

A total of seven submissions were made in relation to this consultation. Five were from licenceholders and two were from professional bodies. A summary of the comments and the Commission's response is contained below.

Financial Resources Requirements	Industry comment	FSC's Response
<i>General</i>	Trying to supply a set of rules that covers different types of licensed business is going to lead to more issues than it would solve. There are concerns that fiduciaries would face same financial resource rules as banks despite the risks being quite different. This regime would make the Island unattractive.	This comment has been received previously and the Commission's response was and remains that there is not a "one size fits all" approach. The levels of financial resources requirements take account of the different business streams. The compliance burden should not be that much greater than ensuring that the fiduciary is solvent.
<i>Computational Rules</i>	<p>Concerns have been raised over the inclusion of certain items in the computations or notes which may require licenceholders to change their financing.</p> <p>If a licenceholder has a general overdraft facility that may or may not be utilised and is guaranteed by general charge over its assets. It would appear that whilst the charge exists and even if the overdraft facility was not utilised then the value of the assets given in security would have to be deducted in arriving at net liquid capital. This could mean that a financially sound operation would be reporting a deficiency of net liquid capital. It could also affect the ability of the licenceholder to gain third party finance.</p> <p>In deducting guarantees that the licenceholders have entered into to arrive at the net tangible asset figure, there does not seem to be any consideration as to whether or not the guarantee is likely to be called on. Where banks are looking for cross guarantees to support lending this would be a significant restriction on their ability to enter into normal commercial transactions.</p> <p>The minimum net tangible asset requirement computation excludes intangibles. Under IFRS most software, which is a significant asset, is classed as intangible; therefore this measure is not appropriate.</p>	<p>It is possible that some licenceholders may have to change their financing structure – unless the licenceholder seeks and is granted a modification or waiver to the requirement.</p> <p>The intention was to deduct only the amount of existing loans drawn down over which a guarantee is in force. The rule will be amended to clarify this.</p> <p>Whether or not guarantees are likely to be called on would be subjective and difficult to assess. The rationale behind the rule is that regulated entities should not offer guarantees which may jeopardise their financial standing and compliance with the requirements.</p> <p>The treatment of intangibles is in line with current investment business practice where software can be an equally important asset. Also, the calculation of the value of software is subjective and difficult to assess.</p>
FRR Rule 25(4)	Where licenceholders prepare monthly or quarterly accounts, it may be difficult to demonstrate that the required liquid capital has been maintained at all times. Where there is only a small margin, would the Commission require the segregation of assets to meet the requirement?	It is the licenceholder's responsibility to ensure that the requirement is maintained and where there is only a small margin of excess, we would expect licenceholders to undertake checks more frequently than monthly or quarterly. Licenceholders have a responsibility to inform the Commission of any material breach of the rules (Risk Management & Internal Controls chapter) and the Commission will take appropriate action in relation to any such

		notification. This may include a requirement to segregate assets where there is a breach. However, meeting the requirement, albeit by a small margin, is still meeting the requirements and the action taken would only be to require more regular monitoring of the position.
FRR Rule 7 <i>Electronic Reporting</i>	Difficulties have been experienced with the electronic filing system. Some licenceholders find the current system difficult to use, time consuming to complete, and certainly not user-friendly.	It has been agreed that fiduciaries, financial advisers and promoters will not be required to submit returns electronically. The rule will be amended to reflect this. Any current issues with the Financial Return System should be directed to the Head of Operations.
FRR Rule 13 <i>Subsidiary Annual Financial Statements</i>	<p>This will require the licenceholders' auditors to review the accounts of the subsidiaries in order to make the confirmation to the Commission and so there is likely to be a cost to the licenceholder. Would it be acceptable for the directors of the licenceholder to give confirmation to the Commission?</p> <p>Can a definition of "associated company" be included?</p>	<p>The requirement to submit annual financial statements relates solely to trading subsidiaries. Auditors will need to review non-trading subsidiaries' financial statements in order to enable it to sign-off the licenceholder's financial statements therefore an auditor's confirmation should not incur a significant cost.</p> <p>Also, to address the rare case where a subsidiary has a different annual reporting date to that of the licenceholder, the rule will be amended to request the "latest accounts of the subsidiary". The analysis table contained in Section 4 of the consultative document provides the following definition:</p> <p><i>Existing banking definition to be used - "associated company" means:</i></p> <p>(a) any company in which the bank holds more than 20% of the equity shares; or</p> <p>(b) a company, other than a subsidiary, over which the bank is able to exercise a significant influence; and</p> <p>(i) the bank's interest in the company is effectively that of a partner in a joint venture or consortium; or</p> <p>(ii) the bank has a long-term and substantial interest in the company.</p> <p>This definition will be amended so as to refer to all licenceholders, not only banks, and will be included in the definitions section.</p>
<i>Filing of Audited Accounts</i>	Licenceholders would have to file audited accounts for itself, its immediate and ultimate parent company and all subsidiaries and associated companies. The requirement should only be to file licenceholder accounts and those of any subsidiaries or associated companies which are also undertaking activities regulated by the Commission.	This comment seems to underrate the importance of intra-group exposures in some groups. There is also a clear need for accounts from companies that have given a subordinated loan or letter of comfort. However, only trading subsidiaries and associated companies are required to file audited annual financial statements under rule 13. Licenceholders may also seek a waiver where the parent is a non-trading passive holding company.
FRR Rule 21 <i>Claims</i>	It would be preferable if the Commission could state the specific amount of any claim which must be notified to the Commission or an appropriate percentage. The reference to an amount which is "material" is subjective and what constitutes material to one licenceholder may not be considered as material to another licenceholder.	<p>This is covered in more detail by rules 8.18 and 8.19 in the Administration chapter. A cross reference will be added to these rules. However, it is exactly because of the varying sizes and types of licenceholder that one definitive sum is not provided. The Board/management is responsible for determining materiality.</p> <p>Legal proceedings — deposit takers</p> <p>(1) This rule applies to licenceholders authorised</p>

		<p>to carry on regulated activities falling within Class 1.</p> <p>(2) A licenceholder must notify the Commission as soon as it becomes aware of any actual or intended legal proceedings taken by or against it where the amount claimed or disputed is likely to exceed —</p> <p>(a) £500,000 sterling or its equivalent in another currency, or, where applicable</p> <p>(b) 5% of the licenceholder’s LECB, whichever is the lower.</p> <p>(3) Nothing in this rule requires a licenceholder to disclose any matter subject to legal professional privilege.</p> <p>Legal proceedings — investment, company and trust service providers</p> <p>(1) This rule applies to licenceholders authorised to carry on regulated activities falling within Class 2, Class 4 or Class 5.</p> <p>(2) A licenceholder must notify the Commission as soon as it becomes aware of any actual or intended legal proceedings taken by or against it where the amount claimed or disputed is likely to exceed —</p> <p>(a) £10,000 sterling or its equivalent in another currency, or</p> <p>(b) 10% of the licenceholder’s allowable financial resources, whichever is the lower.</p> <p>(3) Nothing in this rule requires a licenceholder to disclose any matter subject to legal professional privilege.</p>
<p>FRR Rule 22 <i>Charges</i></p>	<p>There may be circumstances in which a regulated entity in its capacity as a trustee grants a charge over trust assets. In this case, would the Commission expect the regulated entity to obtain prior approval pursuant to Rule 22(1) and notify the Commission pursuant to Rule 22(2)? Can it be assumed that only charges over property which is beneficially owned by the licenceholder need to be notified? If our assumption is correct, could this be clarified in Rule 22?</p>	<p>This rule should only apply to charges over assets beneficially owned by the licenceholder. The rule will be amended to clarify this.</p>
<p>FRR Section 5 <i>Accompanying notes</i></p> <p><i>Approval from the Commission</i></p>	<p>Note 1 requires historical cost accounting except for certain fixed assets. This may contradict the trend within International Financial reporting Standards, which is moving towards fair value accounting.</p> <p>The Commission should not have the power to withhold approval of change in accounting reference date, issue of a guarantee, entering into any arrangement to grant a charge over its assets and repayment, prepayment or termination of a subordinated loan. It would be an interference with the normal business practice of</p>	<p>The rules/notes will be amended to remove references to historical cost accounting and instead make reference to “generally accepted accounting principles or practice” meaning accounting standards and practices recommended by the International Accounting Standards Board (International Reporting Standards) or by the Accounting Standards Board (United Kingdom Accounting Standards).</p> <p>The Commission gives approval for these for the following reasons -</p> <ul style="list-style-type: none"> • A change in accounting reference date can have the effect of postponing an audit; • The issuance of a guarantee or entering into any arrangement to grant a charge over assets (including the granting of a charge over a

	<p>licenceholders. If a fiduciary enters into these financial arrangements it does not impact on the risks faced by a client. These restrictions may make the Isle of Man less attractive to businesses.</p> <p>If a subsidiary company grants a charge over its assets, would this also require Commission approval, as it could be viewed that the charge is over an asset of the licensed entity.</p> <p>Where approval is required over normal business decisions it would seem that the Commission is seeking to be a participator in the business.</p> <p>If it is necessary that approval be given it is suggested that this should be covered in primary legislation.</p>	<p>subsidiary's assets) could result in a negative impact on the licenceholder's financial resources;</p> <ul style="list-style-type: none"> Subordinated loans include a deed poll under which the lender and borrower undertake to obtain the Commission's agreement before any repayment. <p>The Financial Services Bill states the Commission "may make such regulations as are necessary to give effect to this Act" which would extend to the need for certain approvals; and Schedule 1 states, in discharging its functions, the Commission must have regard to the need for regulatory, supervisory and registration regimes to be effective, and proportionate to the benefits which are expected to result from the imposition of any regulatory burden. The Commission would not, therefore, withhold approval without justification.</p> <p>In order to speed up the approval process for applications for repaying a subordinated loan or granting a guarantee the Commission could issue guidance that such requests should be accompanied by a pro-forma Financial Resources Statement, signed by two directors of the licenceholder, which demonstrates whether the licenceholder would be capable of meeting its net tangible assets and liquid capital requirements after making the payment or granting the guarantee.</p>
<p>FRR Schedule 1 <i>Financial Resources Statement</i></p>	<p>Computational rules are difficult to understand.</p> <p>Refers to related companies as opposed to associated companies. Could a definition of "associated companies" be included in the Rule Book (if it is not defined in the primary legislation) to avoid any confusion with any accounting standards which may be in place from time to time.</p> <p>It appears that the whole of the accumulated loss is taken into account for a subsidiary. If the shareholding is less than 100% then this should be the portion attributable to the licenceholder.</p> <p>Where there is an intermediary company, there may not be a need for adjustment, but this is not covered by the rules i.e. where a licenceholder as a 100% subsidiary A, which is profit-making and A has a 100% subsidiary B, which is loss-making and has to receive a subordinated loan from A. In this scenario, is it necessary for the licenceholder to deduct B's losses?</p>	<p>The Commission will arrange a training session which may resolve these issues.</p> <p>References to related companies will be removed and refer to "associated companies" the definition of which is covered above.</p> <p>This is an interesting and valid point. The rule will be amended to reflect where ownership is less than 100%.</p> <p>The rules do not generally allow for netting-off and therefore the licenceholder should deduct B's losses.</p>
<p>Audit Requirements</p>		
<p>AR Rule 2 <i>Appointment</i></p>	<p>No indication has been given of the level of PII that the Commission would expect for auditors of Fiduciaries. It has been suggested that it should be set at a similar level to that of investment businesses.</p>	<p>The Commission deliberately did not include rules relating to PII for auditors of fiduciaries but would be willing to issue guidance if it is required.</p>
<p>AR Rule 5 <i>Annual Financial</i></p>	<p>It was suggested that the financial statements should be prepared in line with IFRS or UK</p>	<p>Agreed, rule amended as suggested.</p>

<i>Statements</i>	accounting standards and audited by the licenceholders auditor in line with International Standards on Auditing or International Standards on Auditing (UK and Ireland).	
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