

**Consultation on Consolidation and Review of the  
Financial Services Regulatory Legislation**

**A Consultative Paper on the  
Clients' Money and Clients' Investments Chapters of the  
Financial Services Rule Book  
and the format and content of the Annual Compliance Return**

**17<sup>th</sup> January 2008**



**Financial Supervision Commission Barrantee Oaseirys**

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# ***SECTION 1***

## ***1. INTRODUCTION***

On 6<sup>th</sup> March 2006 the Financial Supervision Commission issued a consultation on the scope and nature of the project to review and consolidate the financial services regulatory legislation (“CAROL 1”), with particular reference to the proposed Financial Services Bill. The responses to this consultation can be viewed on the Commissions website. Subsequent consultations were issued on the:

- Regulated Activities Order (“CAROL 2”) - 1<sup>st</sup> June 2006;
- Draft Financial Services Bill (“CAROL 3”) - 21<sup>st</sup> December 2006;
- Financial Resources and Audit Requirements Chapters of the Financial Services Rule Book (“CAROL 4”) - 16<sup>th</sup> April 2007;
- A further consultation on the Financial Resources and Audit Requirements Chapters of the Financial Services Rule Book – 24<sup>th</sup> September 2007; and
- A consultative paper on the financial services Rule Book covering Conduct of Business, Risk Management & Internal Control and Administration - 4<sup>th</sup> December 2007.

This consultation covers the Clients’ Money (Appendix A) and Clients’ Investments (Appendix C) Chapters of the Financial Services Rule Book and the proposed format and content of the Annual Compliance Return which will form Schedule I to the Risk Management & Internal Control Chapter. The updated Annual Compliance Return is simply a consolidation of the individual forms into one. There are several sections to the return. Part I of the form is designed to be completed by all licenceholders. There are further sections for specific regulated activities. It will be expected that all sections that apply to your business will be completed.

Section 2 of this document gives an overview of the Rules and Section 3 highlights the key changes to the current secondary legislation. The attached RoadMaps (see Appendices B and D) show what has happened to the relevant provisions in the current framework.

It would be much appreciated if we could have your comments on these chapters of the Rule Book as soon as possible. The closing date for comments is 15<sup>th</sup> February 2008.

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## **SECTION 2**

### **2. FINANCIAL SERVICES RULE BOOK – OVERVIEW**

This Section gives an overview of the structure and content of the Rule Book and how it will apply to the various regulated sectors. The key differences between the Rule Book and the existing regulatory requirements are highlighted in Section 3.

#### **2.1 Background**

As discussed in CAROL I there will be just one Rule Book that brings together the common standards and requirements that apply across all regulated sectors. Where there are different sector-specific requirements, these will be specified separately within the Rule Book. The Commission will, of course, continue to issue guidance to industry where this is appropriate.

In designing the new Rule Book, we have reviewed rules in the UK, Jersey, Guernsey and other jurisdictions, as well as our own current laws to identify what appear to be the options best suited to the Isle of Man to help our licenceholders to remain competitive and develop their business opportunities globally. Wherever possible, we have simplified the requirements, ensuring clarity and consistency. We have also changed the layout of the Rule Book in order to make the Rules more user-friendly. However, inevitably, where requirements are subject to standardisation, this will result in some changes to sectoral requirements.

The Rule Book will have a number of chapters which will cover each of the following topics –

- Financial Resources
- Audit Requirements
- Clients' Money
- Clients' Investments
- Conduct of Business (including treating customers fairly)
- Risk Management and Internal Control
- Administration

As noted in CAROL I, the project is largely a consolidation of existing regulatory legislation. Most requirements of the Rule Book will be familiar to you as they reflect the current pillars of regulatory legislation (with some rearrangement and standardisation across all regulated sectors).

Some existing Codes will appear in a different chapter of the Rule Book, to be consulted upon separately, or may have been removed and incorporated in the Licensing Policy. The relevant RoadMap will assist you in finding the new location of the rules.

## **SECTION 3**

### **3. FINANCIAL SERVICES RULE BOOK – KEY CHANGES CLIENT MONEY AND CLIENTS' INVESTMENTS REQUIREMENTS**

The rules relating to Client Money and Clients' Investments are a consolidation of the regulatory requirements contained in the following secondary legislation –

- Financial Supervision Commission (Clients' Money) Regulatory Code 1993
- Financial Supervision Commission (Clients' Investments) Regulatory Code 1996
- Investment Business (Clients' Money) Regulations 1996
- Financial Supervision Commission (Stockbrokers) (No 2) Regulatory Code 2003
- Fiduciary Services (Clients' Money and Trust Money) Regulatory Code 2005
- Banking (General Practice) Regulatory Code 2005

#### **3.1 Basis of Approach**

As with the other chapters of the Rule Book, the basis for the review of the Clients' Money and Clients' Investments chapters has been to consolidate existing requirements to make a more universally applicable Rule Book. Where there is a specific sectoral difference, different requirements have been applied.

#### **3.2 Clients' Money**

To assist with your navigation of this consultation, the more significant changes relating to clients' money are highlighted below.

##### ***3.2.1 Application to trust money***

There has been a revision of the format of this chapter to amalgamate the administration of trust money into the administration rules for clients' money, as the money needs to be treated similarly by fiduciaries. Where the fiduciary is also the trustee this is different and this is catered for in the new rules. Whilst client money and trust money are different, in view of the administrative similarities between the two, the draft rules treat trust money *as though* it was clients' money for the purposes of the Rule Book.

##### ***3.2.2 Trust law***

Although the following paragraph from the current fiduciary clients' money code has been removed: "*This Code is not (except where expressly stated otherwise) intended to alter a fiduciary's obligations to any person under company or trust law and should be construed accordingly,*" this is still the case, and it will be included instead within guidance to the new rules.

##### ***3.2.3 Account to be specified in cheques***

The Investment Business Clients' Money Code included a code which instructed the licenceholder to ensure that all cheques, drafts and electronic transfers were made payable to a particular client account as appropriate. This has been retained and so will be a new requirement for fiduciaries.

### ***3.2.4 Records to be kept by licenceholder***

This rule (4.11) is new to the Clients' Money chapter; however, it has been adopted from the Investment Business Conduct of Business Regulatory Code so will only be new for fiduciary licenceholders. It is a requirement to keep proper records of client money received, paid or held by the licenceholder.

### ***3.2.5 Reconciliation requirements***

There are new requirements in this rule (4.13). The Commission must now be notified of any amount outstanding on a Client Money account for more than 1 month. This has been implied or given in guidance to the current regulatory codes; however, it is now integrated into the rule. Also, a record must be kept of every reconciliation and check carried out in accordance with this rule.

### ***3.2.6 Subscription and redemption accounts***

This is a new requirement for collective investment schemes regarding the holding of money in respect of the sale or redemption of units in a scheme. However, it just formalises standard business practice and is not envisaged, therefore, that it will cause any difficulties.

## **3.3 Clients' Investments**

To assist with your navigation of this consultation, the more significant changes relating to clients' investments are highlighted below. However, there are few major changes to this part.

### ***3.3.1 Application to collective investment scheme ("CIS") service providers***

Although this section has always applied to CIS service providers the previous wording did not make this very clear. This rule clarifies how the chapter should apply to CIS service providers.

### ***3.3.2 Borrowing from a client***

This rule (rule 5.10) has been identified for inclusion due to specific issues regarding borrowing from clients having occurred to date.

### ***3.3.3 Loans of investments***

The securities lending market has opened up since the previous codes were written; therefore, this rule has been expanded to reflect the Securities Borrowing and Lending Code of Guidance issued by ISLA.

### ***3.3.4 Appointment of a sub-custodian***

The Investment Business code 4.7 (f) which stated that [the eligible custodian] "will not, if, in acting for a licenceholder, it has appointed a sub-custodian, seek to avoid responsibility for the acts or omissions of its appointed sub-custodian," was perceived to be too onerous. Therefore, a rule which requires that "the custodian will acknowledge in writing that it will not arrange for any safe-custody services to be provided on its behalf by any person other than an eligible custodian" has been added to cover this point. Further guidance is likely to be added for clarity.

### ***3.3.5 Investments etc. held as collateral***

This has always applied to Stockbrokers but now has been extended to apply to all licenceholders authorised to carry on Investment business.

### ***3.3.6 Definition of eligible custodian***

The definition used to include “banking institution”. This has been replaced by “a licenceholder authorised to carry on safe-custody services”, which will still include banks that are authorised to carry on this type of regulated activity but will also include other types of licenceholders authorised to carry on safe-custody services.

### ***3.3.7 Use of eligible custodian***

In rule 5.6 (5)(d) the date specified by the licenceholder for a statement to be prepared must be no earlier than **4** weeks before the statement is delivered. This has been reduced for most investment business licenceholders to bring them into line with the current Stockbrokers Regulatory Code and Jersey’s Regulations.