

Main Amendments to the Financial Services Rule Book 2008 (“the Rule Book”)

The Rule Book is made up of a number of Parts, many corresponding to the titles of the existing regulatory codes. Each Part of the Rule Book has been subject to consultation with the industry. We have considered all of the consultation comments received, taken points on board where appropriate and made changes accordingly.

With the exception of the renumbering of rules, the main amendments in relation to each part of the Rule Book are highlighted below.

1. General Points

Several comments were received that certain rules do not work for licenceholders that are not corporate entities. The rules have been drafted with the assumption that all new licenceholders will be a corporate body as the Commission has agreed this in relation to the licensing policy. Guidance will therefore be issued, or exceptions and modifications can be sought, in relation to the remaining sole traders or partnerships. In addition the reference to “the Board of a licenceholder” has been amended to “responsible officers”.

For consistency, all references to “days” have been changed to “business days”.

2. Financial Resources

The following rule has been amended as follows:-

Rule 2.34 – Claims

A licenceholder must notify the Commission as soon as it becomes aware of a claim in writing against it where the amount claimed is likely to exceed the lower of £10,000 or where applicable, 10% of the licenceholder’s minimum net tangible asset requirement.

3. Clients’ Money and Trust Money

Separate rules for trust money are contained in chapter 4 of this part which should clarify the position.

Rule 3.3 - Meaning of “client bank account”

The definitions of the different types of client bank accounts seemed to cause some confusion in the industry. The rule has therefore been reworded to clarify that the “designated client bank account” is one where the client has selected the bank and can hold the monies of more than one client provided they have all selected that particular bank, and the “separate client bank account” holds only the money of one client but the client will not necessarily have selected the bank.

The Investment Business (Clients' Money) Regulations 1996

These Regulations which -

- (i) declare that clients' monies held by licenceholders are held on trust and
- (ii) provide for the distribution of clients' monies between clients in the event of a failure of the licenceholder, where there is a deficiency on the clients' accounts of the licenceholder or in the event of the default of a bank with which the clients' monies are held

have been updated, simplified and incorporated within the client money rules rather than having separate regulations (see Chapter 3 of Part 3).

4. Clients' Investments

There have not been any key changes to this part since consultation. Some minor rewording to Rule 4.11(2) has been carried out to clarify the point about remuneration.

5. Audit Requirements

Rule 5.10 – Contents of Audit Reports

This rule has been amended slightly to include the words "to the best of the auditor's knowledge and belief".

Rule 5.18 – Contents of Audit Reports

This rule has been amended slightly to include the words "to the best of the auditor's knowledge and belief".

6. Conduct of Business

Rule 6.4 - Cold Calling

The new rule on cold calling, which was based on the current requirements imposed on stockbrokers by the UK Financial Services Authority, has been somewhat simplified after consultation comments.

Rule 6.39 - "Retail investor"

The term "retail investor" has been restricted to individuals or other clients who elect in writing to be treated as retail. Non-retail investors would therefore be clients who are not individuals. However, where an individual wishes to be treated as non-retail, he must request this in writing, as is currently the requirement, but in addition, there is a new onus on the licenceholder to undertake an adequate assessment of the client's expertise, experience and knowledge to ensure that the client is capable of understanding the risks involved in making his own investment decisions.

Rule 6.59 – Services to overseas schemes

This rule relating to services for schemes established outside the Island was considered to be unduly onerous. As it was drafted, an administrator would have needed the Commission's consent to administer any and every piece of new non-Isle of Man domiciled business. The rule has been amended so that notification only is required for each piece of new non-IOM domiciled business.

Exempt schemes.

Comments were received in response to the consultation on the Regulated Activities Order regarding issues in relation to exempt schemes. It was considered that it is important that services to schemes are governed under Class 3 as proposed but some modification of the application of the Regulated Activities Order and Exemptions Regulations was necessary to ensure that the provision of services to exempt schemes and to exempt managers of exempt schemes is targeted at an appropriate level. Consideration was also given to how the rest of the Rule Book would apply to this specific activity. As a result rules 6.53 and 6.56 in this chapter no longer apply to exempt schemes and rule 6.59 only requires notification for exempt schemes.

7. Administration

Rule 7.7 - Acquisition of shares of a company

As it was highlighted that as drafted this rule could have significant implications on fiduciaries, it has been amended to show that it does not apply to nominee companies and shelf companies.

8. Risk Management and Internal Control

Rule 7.19 – Legal proceedings – investment business and CIS, company and trust service providers

This rule has been amended to state that a licenceholder should notify the Commission where the amount claimed or disputed is likely to exceed £100,000 or 10% of the licenceholder's minimum net tangible asset requirement, whichever is the lower.

9. Schedule I.1 – Interpretation

The definitions schedule is now complete and in the main, replicates existing definitions with some new additions. The attached RoadMap highlights the differences and interested parties will have until 6th May to make any comments on these definitions.

10. Anti-Money Laundering and Countering the Financing of Terrorism (“AML/CFT”)

The consultation process on Part 9 of the Rule Book covering the AML/CFT provisions was undertaken separately to that of the other parts of the Rule Book. The Joint Anti-Money Laundering Advisory Group (“JAMLAG”) has played a particular role in this process as a forum for discussion.

Rule 9.2 - Interpretation

The definition of **beneficial owner** in respect of legal persons has been amended to cover those persons holding more than 25% of the shares or voting rights in the legal person, or a natural person who otherwise exercises control over the management of the legal person.

In respect of legal arrangements, the definition of beneficial owner no longer includes beneficiaries. However, Rule 9.6 has been amended to clarify that licenceholders must identify any known beneficiaries of legal arrangements. Rule 9.8 has been added to require that a payment of income or capital must not be made to a beneficiary unless the licenceholder has identified the beneficiary and verified their identity.

The amendments regarding beneficial owners and beneficiaries have required consequential changes in respect of a Politically Exposed Person at Rule 9.2 and Rule 9.11. We do not believe these changes to be substantive, but simply clarification as a result of the aforementioned amendments.

The definition of **shell bank** has been amended and definitions of **consolidated supervision** and **financial services group** added.

Rule 9.6 – Customer due diligence procedures

Rule 9.15 – Ongoing monitoring

Rules 9.6 and 9.15 have been amended to incorporate the provisions on non-face to face business which were previously drafted as a separate Rule.

Rule 9.7 - Source of Funds

Rule 9.7 outlines that licenceholders must take reasonable steps to establish the source of customers’ funds. The Draft AML/CFT Handbook issued in January 2008 covered the requirement to obtain information on source of funds for all customers not just higher risk customers. This has been incorporated into the Rule Book for consistency. The Commission will clarify, in the Handbook, that this provision does not require licenceholders to automatically verify source of funds for all customers.

Rule 9.10 – Introduced Business

This rule has been amended to include within the written terms of business between licenceholders and Eligible Introducers the provision that introducers must provide records or copies of records if they are no longer able to comply with the

requirements at paragraph 8(6) of the Criminal Justice (Money Laundering) Code 2007.

Rule 9.16 – Retention etc. of records

This rule has been amended to include general provisions for keeping records of customer due diligence information and documentation. The specific record keeping requirements for anonymous accounts at Rule 9.3 have been removed as a consequence.

25th April 2008