

**REPORT ON THE ISLE OF MAN AGAINST THE CRITERIA FOR ASSESSING
NON COOPERATIVE COUNTRIES AND TERRITORIES**

This report takes into account and represents all information that was available to the reviewer as
of June 2002

I. INTRODUCTION

A. General

The Isle of Man is one of the offshore centres which are a Dependency of the British Crown. It enjoys a special relationship with the EU on the Basis of Protocol 3 to the United Kingdom's Treaty of Accession to the European Community of 1972. However, it is not covered by the EU Money Laundering Directive.

The Isle of Man's financial sector currently contributes the largest part of GDP accounting for well over 30% of the aggregate figure. Total deposits as at March 1999 stood at approximately DM 71.6bn (£22.85bn).

B. Anti-money laundering policy and control

The legislation of major relevance for countering money laundering includes the following:

1) Criminal Legislation

Drug Trafficking Offences Act 1987. This not only made it an offence to assist another to retain the benefits of drug trafficking but also introduced powers to require the production of related information and documents and to confiscate the proceeds of drug trafficking.

The **Prevention of Terrorism Act 1990** creates the offence of assisting in the retention or control of terrorist funds and the concealment or transfer of such funds.

The **Criminal Justice Act 1991** permitted the Isle of Man to meet the requirements of the Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (Vienna Convention) which has been applicable there since 1993, and included powers to enable mutual assistance in criminal matters to be rendered on the same basis as set out in the European Convention of 1959 on Mutual Assistance in Criminal Matters.

The **Drug Trafficking Act 1996** extended the 1987 Act and includes the offences of failing to disclose the knowledge or suspicion of the laundering of proceeds of drug trafficking and of prejudicing an investigation by tipping off.

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The **Criminal Justice (Money Laundering Offences) Act 1998** extended the 1990 Act to criminalize the laundering of the proceeds of all serious crimes (all-crime-approach) and introduced a maximum sentence of 14 years' imprisonment for certain offences. It formed the basis for the **Anti-Money Laundering Code 1998** which was amended by the **Anti Money Laundering (Amendment) Code 1999**.

2) Company Legislation

Company law on the Isle of Man derives principally from the following sources:

- **Companies Act 1931**, last amended by the Companies (Transfer of Domicile) Act 1998;
- **Limited Liability Companies Act 1996**;
- **Single Member Companies Act 1993**.

Company law is largely based on the English system. Companies take the form of private and public companies and branches of foreign companies. The private company is the form most frequently encountered in the Isle of Man.

The Companies Registry which has responsibility for company registrations has recently been transferred to the Financial Supervision Commission (FSC).

There is no provision in the Companies Act which requires Isle of Man Registered Companies or Registered Foreign Incorporated Companies to disclose the identity of their beneficial owners.

Moreover, a Limited Liability Company (newly introduced in 1996) need only disclose its name and the identity of its shareholders to the Companies Registry. The names of any beneficial owners need not be disclosed.

Special arrangements are in place for **Corporate Service Providers**. These are natural or legal persons on the Isle of Man who by way of business set up and administer companies on behalf of third parties or provide as service a registered office, a business address or resident directors. While such providers are subject to the Anti-Money Laundering Code 1998, they are at present unregulated.

The Isle of Man intends to implement a new system before the end of 2000 to place all corporate service providers under the supervision of the FSC. It is also planned that the providers will be required to know the beneficial owners of the companies for which they provide services and can be required to disclose this information to the authorities.

However, at present this is not to include mandatory public disclosure of beneficial ownership by the corporate service providers.

If necessary a similar arrangement is subsequently to be introduced for trust service providers as well.

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3) Trust legislation

For trusts, registration is not required.

4) Anti-Money Laundering Codes 1998 and 1999

(a) Anti-Money Laundering Code 1998 (effective 01/12/1998)

Among others, the 1998 Code imposed on the businesses concerned the obligation

- to introduce preventive systems and procedures to establish customer identity ("know your customer");
- to keep the relevant records for a period of at least five years;
- to provide staffing training; and
- to report suspicious transactions and keep a register of disclosures.

The Code applies not only to conventional financial service providers but also to estate agents, company and trust service providers, casinos, bookmakers, lawyers, accountants and other relevant business.

(b) Anti-Money Laundering (Amendment) Code 1999 (effective 01/12/1999)

Whilst the 1999 Code extended the definition of "regulated person" to include building societies established on the Isle of Man and in the UK, the obligation to establish identity was not inconsiderably restricted in that business relationships formed before 1 December 1998 were excluded from this obligation.

(c) Guidance Notes

The Code is supplemented by the (revised) Guidance Notes of the FSC. These set out the requirements to be fulfilled for institutions to be regarded by the FSC as having discharged their obligations under the revised Code. The Insurance and Pensions Authority (IPA) has issued similar Guidance Notes for the insurance sector though these stipulate only that the declaration of compliance with the Code and the guidelines is to be certified by external auditors. While the guidelines are not legally binding, compliance with them is a strong indication that business practice is in conformity with existing regulations.

5) Confidentiality

The Isle of Man has a reputation as a secure and discreet financial centre, although there is no general secrecy or confidentiality statute. Instead, client confidentiality follows common law precedent (which is the same as in the UK) and is overridden only by obligations under criminal law.

There is a difference to some offshore centres in that the beneficial owners of a company need not be disclosed to the Isle of Man authorities on incorporation, nor is there any obligation to supply to third parties information on the identity of settlors, beneficiaries and trustees of trusts.

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The use of nominee partners or shareholder is permitted, and widespread use is made of this. In many instances the nominees act on the basis of a trust instrument stating on whose behalf they are acting. This instrument is generally deposited with the registered company or with the beneficial owner. Neither the instrument itself nor its content is disclosed or transmitted to any third parties in the absence of a court order or pursuant to a request to relevant business under the Anti-Money Laundering Code.

Exceptions to the above are made only in the following cases:

- Exchange of information between the tax authorities of the Isle of Man and the United Kingdom on the basis of double tax agreement existing between them.
- Investigation by the tax authorities of the Isle of Man concerning a resident of the Isle of Man for suspected tax evasion.
- Involvement of a company in criminal activities or in other cases of overriding public interest (right of courts to be informed).
- Under existing anti-money laundering regulations which are comparable to those in force in the United Kingdom.
- Exchange of information between the Isle of Man Customs and Excise and the United Kingdom Customs and Excise by virtue of the Customs and Excise Agreement between the two jurisdictions.

II. ASSESSMENT OF EXISTING RULES AND PRACTICES AGAINST THE 25 CRITERIA

A. Loopholes in financial regulations

Criterion 5:

Although the Anti-Money Laundering Code 1998 appears at first sight to incorporate clearly defined provisions establishing customer identification requirements (cf. regulation 4, sub paragraph 1 for direct business associates, regulation 5, sub-paragraph 1 for one-off transactions and regulation 6, sub-paragraph 1 for "eligible business"), there are various exceptions which are to be regarded as excessively broad.

- (a) In this respect, the substantial restriction of the scope of the Code effected in the Anti-Money Laundering (Amendment) Code 1999 should at first be cited. Restricting the obligation of identity verification to business relationships taken up after 1 December 1998 means that a considerable proportion of existing customers is not properly identified. The Authorities of the Isle of Man recognized the problem and have stated that they are considering a phased plan to ensure rapidly the comprehensive verification of the identity of holders of the existing stock of accounts.

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- (b) The following arrangement also is to be criticized:

According to the exceptions to the verification of the identity of the customer set out in regulations 4 to 6 (in sub-paragraphs 2 and 3 in each case), it is regarded as sufficient if there are "reasonable grounds" for believing that the potential customer is a member of one of the listed groups (i.e. such as a regulated person an authorised credit or financial institution or a registered legal practitioner).

In this context it is significant that the persons concerned may submit an appropriate declaration confirming that they belong to one of the groups (Acceptable Applicant's Certificate). It appears to be excessive that the submission of such declaration is deemed to constitute "reasonable grounds" or even positive proof as the statement is not verified. In fact, this practice is ultimately tantamount to dispensing with verified identification in the cases in question.

It is true that in the case of "introduced" financial business the "introducer" is obliged to verify the customer's identity and to supply such information on request to the financial institution in question (the "relevant person").

But even such procedure does not imply that (potential) money laundering activities will generally be brought to the attention of the institution in question at an early stage, i.e. if possible before the business relationship is established (see also Criterion 13b).

The Authorities of the Isle of Man also recognised a possible problem. Clarification of the Guidelines seems very necessary.

- (c) Moreover, the list of customers excepted from the identification requirement may appear to be very widely drawn.

For instance, the fact that an applicant for business is not in all cases a credit or financial institution based in a FATF member country (or is incorporated there) is not fully consistent with Recommendation 11. It may include inter alia lawyers. However, it is noted that lawyers are eligible if they are licensed for financial operations and regulated as financial institutions.

Criterion 10

Whereas earlier legislation to counter drug trafficking and terrorism included a formal obligation to report suspicious transactions, the Criminal Justice Act 1998 makes provision only for a more indirect, de facto "obligation" to the effect that only persons who immediately report suspicious transactions to the police or customs authorities are immune from prosecution for money laundering. Accordingly, the FSC Guidelines also provide that disclosures of suspicious transactions that are not connected with drug trafficking or terrorism are voluntary rather than mandatory under the law, but disclosure may be cited as a defence to a money laundering charge (other than the Guidelines of the IPA, which evidently proceed from a general obligation to report suspicious transactions.) In view of the fact that with a merely indirect "obligation" the number of suspicious transaction reports will be only as big as the danger of being prosecuted for money laundering, this

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cannot be seen as an efficient nor mandatory means of enforcing the reporting of suspicious or unusual transactions.

Criterion 11

The penalty for contravention of the Code is six months imprisonment or a fine not exceeding £5,000. Nevertheless, it seems problematic that neither FSC nor IPA has the power to levy fines. In addition, there is no sanction for failure to report in regard of the “de facto obligation” to report all crimes suspected activity.

In cases where a custodial sentence for breaches of the Code is unlikely, the maximum fine was set at too low a level to act as a deterrent. In particular the possibility of imposing other regulatory measures is no substitute for a non-existing perceptible fines regime for non-criminal regulatory breaches. In this respect Criterion 11 could be considered as met.

The authorities should raise the penalties for non-compliance with the preventative measures set out in the Code, and with the regulatory standards. This might be achieved through enhanced criminal sanctions for non-compliance with the Code, and through the introduction of a fines regime for non-criminal regulatory breaches.

The assessment is that Criterion 11 is not met.

B. Obstacles raised by other regulatory requirements

Criterion 13

“Eligible introducers”

As the law stands in the Isle of Man, financial transactions with banks and similar institutions may be concluded not only directly with the persons or companies concerned but also indirectly through interposing so called “eligible introducers” (see also Criterion 5 under b).

Under the FSC’s Guidelines, eligible introducers can be regulated financial institutions, authorised financial institutions in FATF member countries and in Jersey or Guernsey and advocates or accountants belonging to a professional body enforcing standards equivalent to those in the Anti-Money Laundering Code 1998.

This is a matter of concern to the extent that it is seen as adequate for the eligible introducers to have exclusive access to information on the beneficial owners of the funds in question.

As also noted in other evaluations, in business relationships of this kind it is not acceptable for the financial institutions concerned to have no current information on the beneficial owners of the funds.

Where financial institutions depend on the information furnished by intermediaries on the identity of customers or beneficial owners they will neither be able to assess themselves whether or not a transaction is to be regarded as suspicious nor to guarantee compliance with identification obligations in general.

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Added to this is the fact that financial institutions have no other means of acquiring the relevant information, as only the judicial authorities must be notified on demand (and subject to narrowly defined conditions) of the identity of the beneficial owners of a company.

C. Obstacles to international co-operation

Criterion 15

Mutual assistance with the Isle of Man is largely on a non-treaty basis, hence only in relation to some jurisdictions and with regard to specific offences is the Isle of Man obliged to respond to requests for assistance. Moreover, the European Convention on Mutual Assistance in Criminal Matters and the additional protocol thereto apply only to the United Kingdom, not to the Isle of Man. The Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime of 1990 also applies to the Isle of Man, which has in addition recently become a member of the Egmont Group.

In the same way as authorities in the United Kingdom, Isle of Man authorities may co-operate with other jurisdictions in the search for and seizure, retention and confiscation of assets if they are linked to crimes punishable both in the other jurisdiction and in the Isle of Man. In addition, the Criminal Justice (Money Laundering Offences) Act of 1998 confers a statutory power for information contained in suspicious transaction reports to be passed to foreign authorities. However, the necessary conditions of Section 17I of the Criminal Justice Act 1998 must be fulfilled and the Attorney General must have given general or specific permission, if necessary imposing restrictions.

Bearing in mind that the FATF obligations call for spontaneous or "on request" co-operation, the above requirements (specifically that of permission from the Attorney General) may be seen as arrangements imposing disproportionately severe conditions on the exchange of information from suspicious transaction reports.

However, this is altered by the general consent of the Attorney General on 3 December 1999, in which he gave advance approval for the disclosure of intelligence to authorities in the United Kingdom or other specified jurisdictions in specific case constellations and subject to precisely designated conditions.

In view of the limited scope of application of this consent, much of the transmission of information on cases is still subject to these conditions.

It is the opinion of the review group that these conditions should be withdrawn. However, they do not constitute in themselves sufficient grounds to conclude that criterion 15 is met. Therefore, this criterion is not met.

Criterion 20 and 21

- (a) In the few known cases of enquiries addressed to the Isle of Man in connection with action to counter money laundering of investment fraud, replies have generally been forthcoming within a period of three to eight months, so that criteria 20 and 21 are not fulfilled in this respect.

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- (b) Even when the general consent of the Attorney General is taken into account, the impression remains that the Isle of Man attaches very considerable significance to the rights of its residents who are the subject of foreign requests for assistance and makes considerable demands both with regard to the request for assistance per se and to the documentation to be furnished. This is also shown by the fact that the general consent given subject to specific conditions applies as it is only to the transmission of certain information to authorities in the United Kingdom and in specifically listed countries.

Nonetheless, this impression is not sufficient to enable criterion 20 or even 21 to be regarded as met.

D. Inadequate resources for preventing and detecting money laundering activities

Criterion 23

Up-to-date figures on personnel at the relevant supervisory authorities of the Isle of Man are available only for the FSC (2000: 27; 1998: 23), the IPA (1999: 16) and the Fraud Squad (1999: 8). Additionally there are said to be plans to increase to thirteen the number of staff in the Financial Crime Unit engaged on countering financial crime.

Given this background, it cannot be ascertained within the scope of this report whether these agencies are understaffed (as contended in some instances), taking account of the duties assigned to them and the size of the Island's financial sector.

III. CONCLUSION

The Isle of Man has a comprehensive anti-money laundering system. It has in place a system for reporting suspicious transactions. Where the underlying criminal conduct is drug trafficking or terrorism, the obligation to report is a direct one. Where the underlying criminal conduct is another predicate offence, the reporting is an "indirect obligation": failure to make a report potentially leaves one open to a charge of money laundering; making a report is a defence against such a charge. During the review process the issue was raised as to whether an "indirect reporting requirement" is adequate and consistent with FATF Recommendations or whether the obligation should be a direct one for all predicate offences. FATF has agreed to consider the issue and will need, following this exercise, to discuss further with the authorities the adequacy of the suspicious transaction reporting system in the Isle of Man.

The Isle of Man allows certain intermediaries, and individual, which are subject to the same anti-money laundering standards and supervision as financial institutions, to introduce business to banks and financial institutions on the basis that the introducers themselves verify the identity of the customer. In addition, the jurisdiction allows certain institutions based in certain overseas countries, subject to equivalent anti-money laundering systems, to introduce business, without separately verifying the identity of the client. The banks and the financial institutions in Isle of Man are only required to know the name of the client but not to verify the identity separately. There is concern as to whether such a system is consistent with FATF Recommendations and provides sufficiently rigorous checks on the identity of clients of banks and financial institutions, especially in cases where the

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introducer is not a financial institution. The FATF has decided to consider the issue and will need, following this exercise, to discuss with the authorities and adequacy of introducer system in the Isle of Man.

The lack of a stringent scheme to apply the new rules of customer identification for accounts opened prior to their entry into force is also a source of concern. The new rules for customer identification verification were introduced in the Isle of Man in 1998.

The review group noted the intention of the Isle of Man authorities to ensure rapid verification of customer identity of all existing accounts and its readiness to review this year its suspicious transactions reporting system with a view to making it mandatory on an all crime basis.

The following information has been used to draft this report:

- Consent from the Attorney General to the Financial Crime Unit
- Anti-Money Laundering Code 1998
- Anti-Money Laundering (Amendment) Code 1999
- Guidance Notes of the FSC
- Mutual Evaluation Report presented to the FATF (FATF – VI.PLEN/21)
- UK Review of Financial Regulations in the Crown Dependencies (“Edwards Report”)
- International Narcotics Control Strategy Report 1998
- Draft Mutual Evaluation Report by the Offshore Group of Banking Supervisors (OGBS)