

Consultation on the Review of Financial Services Legislation

**Draft Amendments to
the Regulated Activities Order 2009,
the Financial Services (Exemptions) Regulations 2009
and the Financial Services Rule Book 2009.**

**This consultation will be of particular relevance to
all licenceholders and exempt and excluded persons and businesses
conducting payment services**

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Financial Supervision Commission Barrantee Oaseir

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SECTION 1 - INTRODUCTION

1.1 Background

Draft amendments to the Regulated Activities Order 2009 and Financial Services (Exemption) Regulations 2009

The Regulated Activities Order (“RAO”) is an essential piece of secondary legislation under the Financial Services Act 2008. It specifies and defines the activities which constitute “regulated activities”, and sets out “exclusions” (i.e. activities which are not regulated activities).

The Financial Services (Exemption) Regulations (“ERegs”) set out exemptions for certain persons from the need to hold a licence under the Financial Services Act 2008. Exempted activity remains regulated activity but it can be performed without a financial services licence.

Changes to these pieces of legislation may mean that activities that were previously excluded or exempt from requiring a licence become licensable. Therefore, it is very important that anyone relying on any exemption or exclusion considers the changes thoroughly to ensure that any change to their position is understood, and any necessary action is taken.

Draft amendments to the Financial Services Rule Book 2009

The Financial Services Rule Book (“the Rule Book”) is an important and large piece of secondary legislation. It incorporates the detailed requirements that all of the Commission’s licenceholders must abide by.

Supervision Division and the Policy and Legal Division maintain data concerning the interpretation of particular Rules, and also data on potential changes / additions etc. that may be needed to maintain the accuracy and functionality of the Rule Book, including those raised by licenceholders.

Method

As anticipated, the number of amendments this year is fewer than those made in 2009, so rather than repealing and replacing the legislation with 2010 versions, it is proposed that the 2009 versions are simply amended. However, in order to make the consultation as user-friendly as possible the attached Appendices of the RAO, ERegs and the Rule Book show all of the proposed amendments in tracked changes as if full replacement versions were to be produced. In addition, the more significant changes are highlighted in Section 2. This should assist with your navigation of the consultation and give some background into the reasons for the proposed changes.

As with previous consultations, where the style and layout of the legislation has been modernised, any changes that are simply reformatting or relate to style but where the meaning is unchanged are not in tracked changes and have not been highlighted.

It is anticipated that all amendments will become operational on 1 January 2011.

1.2 High level rationale

The Financial Supervision Commission's ("the Commission") regulatory objectives are set out in section 2 to the Financial Services Act 2008. These are:

- (a) securing an appropriate degree of protection for the customers of persons carrying on a regulated activity;
- (b) the reduction of financial crime; and
- (c) supporting the Island's economy and its development as an international finance centre.

The proposals in this paper support objectives (a) and (c).

In addition to this, under paragraph 3 of Schedule I to the Financial Services Act 2008, the Commission is required to give consideration to certain factors.

The table below sets out the list of factors contained in paragraph 3 of Schedule 1 that have a bearing on the proposals.

FACTOR	INFORMATION
The need for the regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden.	The amendments to the legislation are required to ensure that it remains effective and proportionate. In addition, many amendments have been proposed as a result of comments from industry and therefore by revising the requirements the Commission demonstrates that it is responsive to commercial developments.
The desirability of implementing and applying recognised international standards.	By ensuring that the regulatory requirements meet international standards, the Island maintains its international reputation.
The need to safeguard the reputation of the Island.	By maintaining an effective regulatory regime, there is an appropriate degree of protection for customers and the reputation of the Island is safeguarded.
The international character of financial services and markets and the desirability of maintaining the competitive position of the Island.	By ensuring that the regulatory requirements are up-to-date, the Island maintains its competitive position.
The desirability of facilitating the development of the financial services industry.	An effective and up-to-date legislative framework will facilitate the development of the financial services industry.

1.3 Consultation process

The Commission views open dialogue with industry and other stakeholders as an essential element in developing an optimal regulatory framework. The Commission therefore appreciates the time spent reading and commenting upon these proposals.

The proposal, together with a series of important questions, is set out in section 2. While comments should cover the specific questions, any general comments and observations will be welcomed.

The closing date for comments is **31 August 2010**.

We would be most grateful if comments could be received as soon as possible and no later than the above date.

Responses should be sent in writing or by e-mail to:

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The purpose of this consultation is to obtain views and gather evidence from which to take an informed decision on the proposed amendments to the legislation. A response to this consultation will not necessarily result in a change to in the proposals.

A summary of the comments received along with the Commission's response will be published on the Commission's website after all comments have been considered.

Anonymous submissions will not be considered or included in the summary of comments. Being mindful that public identification of respondents is likely to serve as a deterrent to submission, **no respondents will be publicly identified**.

SECTION 2 - PROPOSALS

2.1 Key changes to the Regulated Activities Order

A revised version of the RAO showing all proposed amendments (other than formatting or style changes) in tracked changes is included in this consultation as Appendix A. The key changes are -

Class 2 – Investment Business

Exclusion 2(c) - Groups and joint enterprises has been amended to clarify that the exclusion applies only to activities undertaken solely for the group and does not extend to activities undertaken for the clients of any company within the group.

Class 8 - Money Transmission Services

Class 8(2) – has been widened to the “provision and execution of payment services, either directly or as agent”, which includes the activity of money transmission. This amendment may result in persons not previously licensed by the Commission, undertaking a regulated activity from 1 January 2011 and needing to come forward for a financial services licence before that date. It is therefore intended that there will be transitional provisions which will enable persons who have submitted an application for a financial services licence before 1 January 2011 to continue to carry on business until such time as the application has been determined (or until 1 April 2011, whichever is the later). The transitional provisions have not been incorporated into the draft RAO at this stage because the amending legislation that will be drafted following the consultation period will contain those provisions directly.

As a result of this widening of the sub-class, new exclusions for payment service providers are included for –

- Class 1 to affirm that payment services are not deposits and payment institutions are not deposit takers; and
- Class 6 to clarify that although e-money is a payment service it is not done through a payment institution.

In Class 8, some of the existing exclusions have been removed i.e. those relating to groups (as this is now covered by draft new exclusion 8(h)(n); transmissions of payment for goods and services (as this is now covered by draft new 8(h)(e); and credit unions (as there are no credit unions and is therefore unnecessary). There is also a draft new exclusion 8(h) detailing other activities which do not constitute payment services.

In addition, Schedule 2 contains new, additional interpretation relating to payment services.

2.2 Key Changes to the Financial Services (Exemptions) Regulations

A revised version of the ERegs showing all proposed amendments (other than formatting or style changes) in tracked changes is included in this consultation as Appendix B. The key changes are -

Class 3 - Services to Collective Investment Schemes

Exemption 3.6 – Functionaries of exempt or exempt-type schemes which are wholly-owned subsidiaries of licenceholders

This is a new exemption which enables wholly-owned subsidiaries of licenceholders to provide certain services to exempt schemes without requiring to be licensed under the Financial Services Act 2008 provided that –

- (a) the parent licenceholder of the wholly-owned subsidiary holds the requisite Class 3(11) and 3(12) licence permissions;
- (b) the company appointed to the exempt scheme is a wholly-owned subsidiary of the licenceholder;
- (c) both the person defined at (b) and the licenceholder have common management and staff;
- (d) the 3(11) permission held by the licenceholder includes the relevant activity to be undertaken by the wholly-owned subsidiary, e.g. ‘trustee’; and
- (e) the licenceholder submits details of the person(s) defined at (b) together with scheme statistics to the Commission on a calendar quarter basis.

This exemption adopts a pragmatic approach to dealing with specific issues which have been identified within the fund management industry.

Exemption 3.8 - Court appointed scheme functionaries

This is another new exemption which exempts a person appointed by the High Court to carry out the functions of a governing body, manager, administrator, trustee, fiduciary custodian or custodian of a scheme following the removal of its existing functionaries.

Class 4 - Corporate services

Exemption 4.4 – Corporate officers and Exemption 4.5 – Nominee services

These exemptions have been amended to require that the exempt person is a **direct, wholly-owned subsidiary** of a body corporate that is licensed to carry on activities of Class 4.

In Exemption 4.4 the wording has been clarified to state that the exempt person’s business must consist solely of acting as director or secretary of the client companies of its parent licenceholder.

Exemption 4.6 – Company officers and employees

Although not amended in tracked changes, the Commission is considering removing sub-paragraphs (4) and (5) which relate to professional associates. The rationale for this is that there are a number of other exemptions such as de minimis and domestic business that unlicensed persons may avail themselves of and if these are insufficient, then it is considered more appropriate for these persons to become licensed as professional officers which is a more logical and consistent approach. If we take this action, we would put in place transitional provisions similar to those described at 2.1.

Questions

What will the effect of the removal of sub-paragraphs (4) and (5) of Exemption 4.6 be on your business?

As a licenceholder, do you use any professional associates?

If you are a professional associate, are you able to rely on the other exemptions in place, or do you envisage the need to seek a licence as a professional officer?

Exemption 4.7 – Domestic services

An additional sub-paragraph has been to the sole or principle trade or business exemption to allow for the holding of the freehold of blocks of flats or apartments in the Isle of Man, where the majority of the flats or apartments are owned by persons who are resident in the Island.

Class 5 – Trust services

Exemption 5.1 – Corporate trustees, protectors and enforcers

This exemption has been amended to state that company B is the **immediate and sole parent** of company A.

Exemption 5.6 – Private trust companies

No changes have been made to this exemption but a question has been raised in relation to the wording “where the administration of the trust or trusts is carried out by a person licensed to do so” and whether this should be interpreted as meaning **all** administration.

Questions

In your experience of providing administration to private trust companies, do you carry on all of the administration?

If not, how would you define the level of administration undertaken?

Class 7 – Management or Administration Services

Exemption 7.2 - Court appointed managers

This is a draft new exemption which exempts a manager appointed by the High Court to manage the affairs of a person, in so far as those affairs relate to the carrying on of a regulated activity.

Class 8 – Money Transmission Services

There are some amendments and a new exemption (Exemption 8.5) which covers transitional arrangements for payment institutions following the inclusion of payment services in the Regulated Activities Order.

2.3 Key changes to the Financial Services Rule Book

A revised version of the Rule Book showing all proposed amendments (other than formatting or style changes) in tracked changes is included in this consultation as Appendix C.

The issues being addressed in the update of the Rule Book are mainly the addition of new rules or amendments to existing rules, which have been revealed as required by practical use of the Rule Book. The key changes are –

New rules

- Rules 3.30 to 3.35 which cover monies held by e-money issuers on behalf of e-money purchasers.
- Rule 6.13A which prohibits reference to any guarantee provided by another entity in marketing material.
- Rule 6.75 which relates to provision of statistical information on a quarterly basis as the Commission requires. However, it is possible that no such statistics are required from certain classes at this time.
- Rule 7.2A which relates to notification of new business names and the rationale for such names. Where licenceholders trade under business names these should be reflected on the licenceholder's licence.
- Rule 7.3A which relates to re-registration and redomiciliation which requires the Commission's prior consent.
- Rule 7.9A which relates to appointments of Isle of Man Resident Officers, Key Persons, Compliance Officers, Money Laundering Reporting Officers and their deputies in exceptional circumstances.
- Rule 7.9B which relates to the provision of references from one licenceholder to another.
- Rule 8.5A which relates to continuing professional development requirements.
- Rule 8.9A which relates to need for a written agreement between the licenceholder and the person providing management and administration services.
- Rule 8.28A which relates to the refunding of fees charged for responding to a complaint which is subsequently upheld.

Amended rules

- Rule 2.9 Annual financial return – this rule has been clarified to state that the annual financial statements must be an original signed by the auditor or a copy of such original.
- Rule 2.11 Accounts of parents and holding companies – this rule has been extended to cover where these bodies are trusts.
- Rule 5.2 Auditors - this rule has been extended to require that where the licenceholder is incorporated under the Companies Act 2006 and the auditor has capped its liability, the liability must not be capped below the level expected by this rule.
- Rule 5.10 Contents of audit reports – this rule has been amended so that the auditor can comment on any failure to keep proper accounting records by exception.
- Rule 5.20 now entitled 'Auditor's letter' clarifies the position where the licenceholder is also licensed to carry on regulated activities falling within Class 1.
- Rule 6.14 Advertisements – this rule has been amended to disapply the rule for radio advertisements.
- Rule 6.29 Knowledge of client – this rule has been significantly enhanced and now includes the Commission's requirements in relation to the fact find.
- Rule 6.30 Suitability – this rule now requires consideration of attitude to risk, age and state of health and provides an opportunity for a family member, friend or professional adviser to accompany the client.
- Rule 6.34 Disclosure and information – this rule has been significantly enhance to make reference to a reasons why letter and its contents.
- Rule 7.5 Acquisition of business etc – this rule has been amended to require that where one licenceholder intends to or has acquired clients from another licenceholder, the clients must be notified of the transfer together with the options available to them. There is also a requirement on the acquiring licenceholder to review those clients' circumstances within 20 business days.
- Rule 7.8 Subsidiaries etc. – this rule has been amended to include notification to the Commission on the closure, sale or winding up of a trading subsidiary. Also, consent must be sought prior to redomiciliation of a subsidiary.
- Rules 7.16 Bankruptcy, winding up, etc.; 7.17 Voluntary winding up and 7.19 Legal proceedings – these rules now extend to wholly-owned subsidiaries.
- Rule 8.10 Changes to activities, services or products – this rule now extends to the sectors or jurisdictions in which the services or products are provided.
- Rule 8.54 Professional indemnity insurance – this rule now clarifies the requirement for a cover note or broker's letter evidencing the cover and confirming that the cover meets the requirements of the rule. Also the period of run off cover has been extended from 12 months to 6 years and, where a third party is acquiring the business, details of the cover should be provided to the third party.
- Schedule 2.3 Note 7 Financial Resources Statement - additional clarification has been provided on the deductions to liquid capital. Note 11 Operating expenses – additional clarification on cost of sales.

In addition there is a new Part 9 of the Rule Book which has been written for those licenceholders who are individually licensed to act as directors, trustees or protectors. This Part 9 is a consolidation of all the relevant rules in Parts 1-8 of the Rule Book, which have then been tailored for these individuals. It is required because this type of

licenceholder is the only non-corporate type, and the wording of the relevant rules in Parts 1-8 of the Rule Book did not suitably reflect the fact that they are not bodies corporate. Meetings have been held with relevant individuals and an earlier draft was circulated to all such licenceholders in May 2010. Amendments to the attached draft result from comments received from the licenceholders concerned.

Question

Relevant licenceholders are currently termed "Professional Officers", but it is known many dislike this term. Do you have any alternative suggestions for a suitable term that covers all relevant licenceholders?

Other issues within the Rule Book

The purpose of the rolling review is to ensure that the regulatory framework is up to date and fit for purpose. A question has been raised as to whether the rules relating to subscription accounts (rules 3.4, 3.16A and 3.24) are "fit for purpose" and reflect current industry practice. This matter has been raised by the Commission with the Fund Management Association and it is intended that their Regulatory Sub-committee will review this. ***We would therefore ask licenceholders which operate such accounts to review these rules and comment on their appropriateness either to the FMA or the Commission or both.***