

SECTION 1

THE REGULATORY STRUCTURE FOR INVESTMENT BUSINESSES - INVESTMENT BUSINESS ACTS 1991 TO 1993

[The Investment Business Act 1991](#), as amended by the Investment Business (Amendment) Act 1993 ("the IBA") is the statutory basis for regulating investment business (see [Appendix A](#)).

1.1 THE GENERAL STRATEGY FOR LICENSING AND REGULATING INVESTMENT BUSINESSES

The Commission's main objectives in regulating investment businesses are to encourage sound and prudently managed business and to deter fraud. The aim of the Commission is to license and regulate only those businesses or activities which it can effectively supervise.

The General Licensing Policy for those seeking a Banking, Investment Business or Fiduciary Services Licence (see [Appendix J1](#)) sets out the general criteria the Commission will normally apply in assessing the fitness and propriety of licence applicants and of individuals with key roles and/or significant influence in respect of those businesses. The specific requirements and considerations applicable to investment business are summarised in the tables in Appendix A to E in the licensing policy. (See also [Section 2](#) below).

The licensing policy applies to applicants for investment business licences, which are required to meet the "fit and proper" criteria, and, on an on-going basis, to licenceholders which must continue to be "fit and proper". (See also [Section 3](#) below).

1.2 LEGISLATIVE FRAMEWORK

[Section 1 \(2\)](#) of the IBA states that "the Treasury may by Order prescribe activities which shall constitute investment business ...". Thus, the definition of "investment business" is contained in the [Investment Business Order 2004](#) (this replaced the Investment Business Order 1991 with effect from 01 December 2004) ("the Order") (see [Appendix B](#)). The IBA then goes on to state in [section 2](#) that: -

"... any person who carries on, or holds himself out as carrying on, in or from the Island, investment business -

- a. in respect of which no investment business licence is in force; or
- b. if such a licence is in force, other than in accordance with the conditions, if any, of the licence, shall be guilty of an offence."

Several points should be noted here.

Firstly, in order to be licensable, investment activity must be carried on by way of business. Thus, private transactions e.g. engaging in investment activities as a director of a private company would be unlikely to fall within the scope of the IBA.

Secondly, investment activity is licensable if it is carried on in or from the Island. This is clarified further in [section 2\(2\)](#) of the IBA. It is important to note that any Manx incorporated company, foreign company registered on the overseas company register, or limited partnership registered here which carries on investment business requires a licence, even if it is conducting its activities abroad. In practice, the Commission is unlikely to grant a licence to an organisation unless it is managed and controlled in the Island, as to do so could potentially leave the Island vulnerable to unscrupulous operators with no accountability in the Isle of Man. (See [Section 2](#) of this publication for further information).

Thirdly, an offence is committed not only if a person conducts investment business without a licence, but also if he conducts activity with a licence but in contravention of any conditions of that licence. The conditions which are attached (under [section 3\(4\)](#) of the IBA) to investment business licences concentrate, in most circumstances, upon the scope of activity which a licenceholder is permitted to conduct. Thus, if he conducts investment activity outside the scope of his conditions, he commits a criminal offence. Also, under [section 14](#) of the IBA a breach of a licence condition lays the licenceholder open to actions for damages at the suit of any private investor who suffers loss.

When an investment business licence is issued, a series of [Regulatory Codes](#) ("the Codes") apply to that licenceholder (see [Appendix C](#)). Information about these Codes is contained in Section 3 of this publication. Should a licenceholder breach any of the Codes, the Commission is empowered to take enforcement action (described in [section 22\(2\)](#) of the IBA).

This is the basic legislative framework for investment businesses licensed by the Commission. There are provisions within the legislation for certain persons to be exempted from requiring an investment business licence even though they are conducting investment business in the Island and this whole area is described in [Section 1.10](#) of this publication.

1.3 DEFINITION - GENERAL INTERPRETATION

The definitions of "investments" and "activities constituting investment business" which together with a number of specified exclusions define the scope of regulation are contained in the Order, a copy of which is contained in [Appendix B](#).

When considering the definition of investment business, attention should be paid to the interpretation provisions in [Schedule 3](#) of the Order as these refine, and in some circumstances widen, the scope of the words and expressions used in Schedules [1](#) and [2](#) of the Order. Examples are as follows: -

- a. Paragraph 1, Schedule 1, under the heading "Dealing in Investments", sets out the relevant activity constituting investment business as "Dealing in investments ... as principal ... or ... as agent".
- b.) Paragraph 1 (e), Schedule 3, defines "dealing" as "buying, selling, subscribing for or underwriting ...".
- c. Paragraph 1 (h), Schedule 3, gives "disposal" an extended meaning.
- d. Paragraph 1 (s), Schedule 3, defines (t) refers to "buying and selling" as including "any acquisition or disposal for valuable consideration".
- e. Paragraph 1 (t), [Schedule 3](#), defines (u) refers to "dealing" as including "offering or agreeing to deal ...".

The definitions in [Schedule 3](#) must therefore be kept in mind when reading the Order as a whole.

It is also important to note how "Investments" are defined in [Schedule 2](#) of the Order. For instance, life assurance and pension products are defined as investments, and so those selling such products are subject to licensing and regulation. It should be noted, however, that neither cash nor land is classed as an investment. Thus, advising clients on bank accounts, etc is not licensable under the IBA (although certain types of activity involving cash and deposits might be regarded as banking activity).

1.4 DEFINITION - DEALING IN INVESTMENTS

The definition of "dealing in investments" reads as follows :-

"Dealing in investments either:-

- i. by a professional dealer as principal; or
- ii. as an agent".

A "professional dealer" is defined either as a market-maker or a person who regularly solicits members of the public to deal in investments. Thus, the activities of private investment companies are unlikely to be caught by this definition.

The definition of "agent" includes dealing under a power of attorney as powers of attorney may be used in place of discretionary investment management agreements. . It also includes acting as a nominee. However, the Commission has exempted from a licensing requirement those nominee companies which are subsidiaries of holders of Isle of Man banking or investment business licences on the grounds that the licence (and the Regulations and Codes applying to the licence) will be extended to the activity of such nominee companies (see [Appendix E2](#)). Also excluded from the scope of the IBA are those nominees whose sole function is to hold shares in private companies for the benefit of those who control such companies. Nominee companies which hold only assets not covered by [Schedule 2](#) of the Order (definition of "investments") do not, of course, require a licence at all. See Sections [1.9](#) and [1.10](#) of this publication for further information.

1.5 DEFINITION - ARRANGING DEALS IN INVESTMENTS

The definition of "arranging deals in investments" reads as follows:

1. Making arrangements with a view to another person dealing in investments.
2. This paragraph does not apply to a person by reason of his making arrangements with a view to a transaction to which he himself will be a party, except in the case of a professional dealer or attorney."

The Commission regards any activity which directly brings about, or would bring about, an investment transaction as "arranging deals" for the purposes of the order. The Commission believes that any activity which contributes directly to the execution of an investment transaction should be regarded as arranging deals.

An obvious example of arranging deals would be giving instructions to stockbrokers on behalf of a client (although merely making introductions to a stockbroker may not be licensable - see [Section 1.9](#) of this publication). Where a "professional dealer" (i.e. one who regularly solicits members of the public to deal in investments) interposes himself between the investor and the market, whether he takes a position or not, he will be regarded as "arranging deals". The Commission considers that "members of the public" may include, amongst others, existing clients of the person arranging the deal and other licensed institutions.

1.6 DEFINITION - MANAGING INVESTMENTS

The definition of "managing investments" reads as follows:

1. Managing investments belonging to another person.
2. Managing investments includes:-
 - a. an attorney managing investments under a power of attorney;
 - b. the provision of safe custody services for investments.
3. This paragraph does not include the provision of safe custody services for bearer investments where:-
 - a. the service provided is limited to safekeeping; or
 - b. safe custody is provided only in connection with a transport or delivery service."

The activity of managing investments may be regarded as having three main elements: advising or deciding, transacting (but not as a principal), and servicing (dealing with such things as dividends, rights issues, etc).

Safekeeping services (e.g. providing a facility limited to receipt of, storage and return of investments) and where there is no other element to the service such as advising or deciding, transacting, or servicing is not considered to fall within the definition of "managing investments".

1.7 DEFINITION - INVESTMENT ADVICE

The definition of "investment advice" reads as follows :-

"Giving to persons in their capacity as investors, or potential investors, advice on the merits of their :-

- a. dealing in an investment; or
- b. exercising any right conferred by an investment to deal in or convert an investment".

The Commission regards any form of activity whereby a person encourages another person to undertake a specific investment transaction (as opposed to advice in general terms) as licensable activity under this

section.

The most obvious forms of investment advice would be evident from verbal and written correspondence where advice is explicitly provided. However, it is quite possible to fall within the definition of 'giving advice' when providing assistance with applications or instructions or when obtaining information or applications for a person. The common test is whether such behaviour is related to a specific investment transaction or series of transactions.

The Commission accepts that it may often be difficult to draw a distinction between investment advice and arranging deals. However, for the purpose of the IBA, since both activities are defined within the Order as 'investment business', whether one encourages someone to undertake a specific investment transaction (advising) or contributes directly to the execution of it (arranging), the activity will still be considered licensable, as long as it is done by way of business.

1.8 DEFINITION - MANAGING ETC. COLLECTIVE INVESTMENT SCHEMES

The definition of "Managing etc. Collective Investment Schemes" reads as follows:-

"5 Acting as manager or trustee of any collective investment scheme, whether or not such scheme is established in the Island, or providing any of the services which the operator of such a scheme would normally undertake".

This should be read in conjunction with paragraph 19 of [Schedule 1](#) of the Order.

Investment business carried on in connection with collective investment schemes is the subject of a separate section. To summarise the position, the general rule is that managers and trustees of collective investment schemes and third party fund administrators require will an investment business licence to operate in or form the Isle of Man. Further information relating to collective investment schemes and their managers/trustees/administrators etc. can be found in the Commission's Regulatory Guide to Collective Investment Schemes, which may be accessed via Handbooks tab on this website.

1.9 EXCLUDED ACTIVITIES

Part II of [Schedule 1](#) of the Order (paragraphs 6-23) lists a number of activities which, whilst on the face of it appear to be licensable, are excluded from the scope of the IBA. It is necessary to peruse the Order itself in order to obtain a definitive list of excluded activities and persons. However, the following exclusions are particularly noteworthy:-

- a. Inter-group transactions/employee share schemes
- b. Any necessary investment advice given in the course of a profession or non- investment business is not licensable (see [paragraph 10, Schedule 1](#) of the Order) unless the person holds himself out as being prepared to provide an investment business service in addition to their professional service.
- c. Any investment related activities carried out by a person in the course of a business licensed under the Corporate Services Providers Act 2000 are excluded to the extent that the person is licensed to undertake that activity under that Act.
- d. The Commission does not intend to regulate those people who merely introduce their clients to licensed businesses in order that they may receive independent advice or be provided with a service where independent discretion is exercised in relation to investments. However, if a person arranges a specific investment deal on behalf of his client with another licensed business or introduces a client to a person other than for an independent service, the activity may be licensable. In order to demonstrate independence, it is generally considered that the licenceholder to whom the client is introduced would have a minimum of six agencies (e.g. in the case of an independent financial adviser) or have access to a significant range of investment products (e.g. in the case of a stockbroker or a portfolio manager).
- e. In the main, the Commission regards the investment activity of trustees as constituting fiduciary rather than investment business (see [Schedule 1](#) Article 2 paragraph 16 of the Order). However, if a trustee holds himself out as providing an investment business service in addition to his trustee service, this would be licensable as investment business. This also applies to a personal representative who holds himself out as being willing to offer investment business services in addition to acting as a personal representative.

The Commission appreciates that professional trustees will possess a range of skills which may include investment expertise. Provided such skills are demonstrated or promoted as part of a trustee service, this would not be considered as holding out as being prepared to offer investment services. However, an advertisement which, for example, explicitly offered an investment service in addition to a trustee service would fall outside of the exclusion – that is, it would be considered to be holding out as providing investment business in addition to a trustee service.

The activities of nominees who hold shares in private companies for the benefit of those who control such companies (as operated by corporate administrators) are also excluded from the scope of the IBA by virtue of [Schedule 1](#) Article 2 Part II paragraph 16 of the Order.

- f. Any investment activities carried on by insurance companies or retirement benefits scheme administrators which hold permits, registrations or authorisations under the Insurance Act 1986 or the Retirement Benefits Schemes Act 2000, will not require an investment business licence (see [Schedule 1](#), Article 2 Part II, paragraph 21, of the Order).

1.10 EXEMPTIONS

In addition to the exclusions contained in [Schedule 1](#), Article 2 Part II of the Order, a number of other persons are exempt from requiring an investment business licence even though their activities are classed as investment business.

These persons are exempted by Regulations made under Section 2(3) of the IBA. Five sets of Regulations have been made under this section:-

- a. Investment Business (Exemption) (Banks and Building Societies) Regulations 1992 ([Appendix E1](#)).
- b. Investment Business (Exemption) (Miscellaneous) Regulations 2001 ([Appendix E2](#))
- c. Investment Business (Exemption) (Certificates of Deposit) Regulations 1992 ([Appendix E3](#))
- d. Investment Business (Exemption) (Fund Managers) Regulations 1999 ([Appendix E4](#))

- e. Investment Business (Group Pension Schemes) Regulations 1996 ([Appendix E5](#))
- f. Investment Business (Exemption) (Temporary Business Continuity Operations) Regulations 2002 ([Appendix E6](#))

Whilst such persons are exempt from a licensing requirement, they are "permitted persons" as defined by section 5(1) of the IBA ([Appendix A](#)). The Commission has powers to carry out investigations, issue directions and request information in respect of any investment business being carried on or which has at any time been carried on by a permitted person or person who has ceased to be a permitted person (see sections 8, 8A and 9 of the IBA ([Appendix A](#))).

SECTION 2

GENERAL LICENSING POLICY FOR THOSE SEEKING AN INVESTMENT BUSINESS LICENCE

2.1 THE COMMISSION'S FIT & PROPER TEST

The Investment Business Act 1991, as amended by the Investment Business (Amendment) Act 1993 ("IBA") requires that: - the applicant for a fiduciary (CSP or TSP) licence;

· an applicant for an investment business licence; and

· any controller, director or manager (including the company secretary and compliance officer) of the applicant;

must be "fit and proper persons".

The fitness and propriety criteria apply both in relation to the initial application for an investment business licence and thereafter to the licenceholder on an ongoing basis. The Commission's [General Licensing Policy for those seeking a Banking, Investment Business or Fiduciary Licence](#) sets out the criteria it will normally apply in assessing fitness and propriety.

2.2 GENERAL LICENSING POLICY AND SPECIFIC REQUIREMENTS FOR INVESTMENT BUSINESS LICENCEHOLDERS

The Commission's [General Licensing Policy for those seeking a Banking, Investment Business or Fiduciary Licence](#) sets out the general principles that apply to all licensed sectors. However, the definition of "investment business" includes a wide range and variety of activities as well as different disciplines and the Commission adapts its regulatory and supervisory approach accordingly. The particular requirements and expectations relating to the different categories of investment business licenceholder are specified in the tables in Appendix 1 to the licensing policy.

The Commission has also made regulatory codes under Section 6 of the IBA, which set out the Commission's requirements in relation to the conduct of investment business and place ongoing objectives on a holder of an investment business licence (see [Section 3](#) below).

2.3 EXEMPTION FOR DISASTER RECOVERY OPERATIONS

[The Investment Business \(Exemptions\) \(Temporary Business Continuity\) Regulations 2002 \(SD589/02\)](#) allow investment businesses regulated in other, approved, jurisdictions to use Isle of Man based computer servers for their disaster recovery arrangements without the need for a licence from the Financial Supervision Commission, subject to certain conditions. Please see the Policy & Practice section on our website home page for further details of this exemption.

SECTION 3

ONGOING REGULATORY REQUIREMENTS FOR INVESTMENT BUSINESSES

3.1 LICENCE CONDITIONS

[Section 3\(4\)](#) of the Investment Business Act 1991 ("the IBA") empowers the Commission to issue investment business licences subject to conditions. A breach of a licence condition imposed by section 3(4) is both a criminal offence and can lay a licenceholder open to action for damages at the suit of any private investor who suffers loss (see [section 14](#) of the IBA).

In general, licence conditions are restricted to defining the scope of business which may be conducted by the licenceholder.

These "standard" licence conditions are attached to most investment business licences, and may be augmented at any time by the imposition of "special" licence conditions, designed to respond to particular problems. [Section 3\(7\)](#) of the IBA enables the Commission to impose specific parts of a regulatory code (see [3.2](#) below) as a special licence condition upon an individual licenceholder should it wish to do so. For example, if there have been serious and/or persistent breaches of the code.

There are five categories of investment business licence. Categories 1 to 4 are listed in the [Financial Supervision Commission \(Financial Resources and Compliance Reporting\) Regulatory Code](#) (see [Appendix C1](#)). Category 5 licenceholders - Stockbrokers - have their own Code, the Financial Supervision Commission (Stockbrokers) (No2) Regulatory Code 2003. By restricting, through licence conditions, the scope of investment business carried on by a licenceholder, the Commission can grade the system of regulation to the risks of the business and its need for working capital. The permitted category of investment business will also influence the Commission's assessment of such things as competence and capacity.

It is important that licenceholders appreciate the significance of the difference between licence conditions and the Codes. Whatever the category of licence, conducting business in contravention of licence conditions risks criminal prosecution and/or civil action at the suit of anyone who suffers loss. The Commission has therefore sought to place the weight of regulation upon the observance by licenceholders of regulatory codes.

3.2 REGULATORY CODES

3.2.1 Regulatory Codes ("the Codes")

Section 6 of the IBA empowers the Commission to issue regulatory codes ("the Codes"). These Codes, which are intended to set standards of good practice and behaviour, apply to each licenceholder. Should a licenceholder breach any of the Codes, the Commission is empowered to take enforcement action. This action will be graded, dependent upon the seriousness of the breach.

Where a licenceholder acts outside the scope of its licence category, whether inadvertently or not, the Commission will expect it to abide by the requirements of any relevant code. For example, the [Clients' Money Code](#) should be applied to any clients' money inadvertently received by a licenceholder, even if that licenceholder is not entitled to receive clients' money within its permitted scope of business. The Codes, applicable to Category 1 to 4 licenceholders, cover the following: -

- a. [Financial Resources and Compliance Reporting](#)
- b. [Clients' Money](#)
- c. [Clients' Investments](#)
- d. [Conduct of Business](#)
- e. [Audit Requirements](#)
- f. [General Requirements](#)
- g. [Advertising](#)

The requirements for Category 5 licenceholders can be found in Appendix C8 Financial Supervision Commission (Stockbrokers) (No 2) Regulatory Code 2003 which covers all areas contained in (a) to (g) above.

Each of these codes is contained in [Appendix C](#) and is discussed below.

A glossary defining many of the terms contained in Codes (a) to (g) above is contained in the [Financial Supervision Commission \(General Requirements\) Regulatory Code and the Financial Supervision Commission \(Stockbrokers\) \(No 2\) Regulatory Code 2003](#).

3.2.2

The financial resources requirements are designed to promote a stable and orderly business environment which inspires confidence by minimising the risk of loss to investors which could arise from over-trading by a licenceholder or from adverse developments in the markets in which it operates. No system can eliminate risk and so the Commission's objective is to minimise risk without over-regulating those licenceholders conducting legitimate and well resourced investment business.

Financial Resources and Compliance Reporting ([Appendix C1](#))

The requirements are directly related to the scope of investment business conducted by the licenceholder and therefore depend upon which category of business it is permitted to conduct.

There are four main categories to which this code applies, which can be summarised as follows (Category 5 licenceholders – Stockbrokers, should refer to the Financial Supervision (Stockbrokers) (No 2) Regulatory Code 2003 – see appendix C8):

Category 1 (Minimum net tangible assets of £5,000 for sole traders and £10,000 for partnerships and companies)

Group (a)- persons who do not control clients' money or assets and who arrange deals only in a limited range of investments (i.e., unit trusts, life and pensions products). Such persons may provide investment advice (other than to occupational pension schemes and collective investment schemes) on other types of investments, but may not arrange deals in them, except for subscriptions to new share issues.

Group (b)- tied agents selling the products of only one product company. Such persons may control clients' money, provided that the product company which the agent represents has provided an indemnity in respect of clients' monies to the Commission in an acceptable form.

Category 2

Group (a) (Minimum net tangible assets of £15,000 and 3 months annual audited expenditure to be maintained as liquid capital.)

- persons who arrange deals in any investment instrument but who do not receive or control clients' money; or
- persons who arrange deals in a limited range of products (as in category 1) but who may control clients' money; or
- persons who act as share distributor or provide share registration or accounting services to collective investment schemes established in approved jurisdictions; or
- - persons who act as investment adviser to occupational pension schemes and/or collective investment schemes.

Group (b) (Minimum net tangible assets of £30,000 with 3 months annual audited expenditure to be maintained as liquid capital.)

- managers of collective investment schemes (except EIFs and PIFs), but only where the manager is administered by a licenceholder who is authorised as a category 4 business.

Category 3 Minimum net tangible assets of £50,000 for Category 3(a) and £75,000 for Category 3(b) licenceholders and 3 months annual audited expenditure to be maintained as liquid capital.

Group (a)

- investment managers and dealers who control clients' money and assets;
- managers of international collective investment schemes (except as provided in category 2 above), including managers of more than one "exempt international collective investment" scheme within the meaning of section 11(7) of the Financial Supervision Act 1988 ("the FSA");

Group (b)

- persons acting as investment manager to collective investment schemes established and operated in another jurisdiction;
- managers of authorised collective investment schemes;
- managers or administrators of EIFs and PIFs;
- investment businesses, other than those included in categories 1, 2 and 4.

Category 4 Minimum net tangible assets of £175,000 and 3 months annual audited expenditure to be maintained as liquid capital.

- licenceholders providing administrative services to managers of authorised and/or international collective investment schemes including PIFs and EIFs (except as provided for in Categories 2 and 3 above).

In addition, licenceholders are required to notify the Commission if its Financial Resources Requirements have or will fall below 110% of the minimum net tangible asset requirement

There are two separate tests of the financial resources of licenceholders - the minimum net tangible asset test and the liquid capital test. The two tests reflect two measures of the solvency of a business; that its assets should exceed its liabilities and that it should be able to meet its liabilities as they fall due.

The net tangible assets test applies to all categories of licenceholder and requires every licenceholder to commit capital resources to the business scaled broadly in line with the requirement for investment in equipment, etc. For example a sole trader life assurance brokerage will be required to have minimum net tangible assets of £5,000, whereas a licenceholder acting as a third party fund administrator will require minimum net tangible assets of £175,000.

The liquid capital test, which applies to categories 2, 3 and 4, is an expenditure-based requirement which focuses upon realisable assets available against a number of months expenditure. The intention is that each licenceholder should have enough liquid working capital to sustain its business for a number of months to provide a cushion against unexpected market shocks or disruption of business and provide time, if necessary, for an orderly reconstruction or winding down of the business.

In addition, the Commission believes that all licenceholders should carry professional indemnity insurance. The level of insurance required is dependent upon the category of business being conducted. For example, it is recommended that category 1 businesses hold professional indemnity cover of not less than £250,000 or three times total revenue, whichever is the greater, whereas the minimum level for higher categories is £500,000. This requirement recognises that licenceholders are subject to a range of different types of risk (e.g., negligence), not all of which can be reduced by a financial resource requirement.

This code contains details of how the financial resource requirements are calculated and specifies a number of adjustments. One of the most important of these adjustments is that monies owing to the licenceholder from other group companies will be excluded for the purposes of calculating the financial resource requirement, except in certain very limited circumstances. Thus, a licenceholder will be expected to "stand alone" financially from the rest of its group.

Although the financial resource requirement is a day-to-day requirement, licenceholders are required to submit financial statements to the Commission at periodic intervals, generally either half-yearly, quarterly or monthly depending upon the Category of licence.

The Commission attaches great importance to accurate and timely reporting. Late, incomplete, or inaccurate returns are never a good sign and are often a symptom of serious problems. In any case, prompt and accurate reporting is an important part of the Commission's criterion that the business shall be conducted with prudence and professional skill, which is part of the "fit and proper" test (see Section 4).

As a consequence of the importance attached to it, the Commission expects that regulatory reporting will be of high quality, accurate and timely - the responsibility for which should be in the hands of an appropriately qualified and experienced individual.

Although the financial resource requirement is a day-to-day requirement, licenceholders are required to submit financial statements to the Commission only at periodic intervals. Generally, categories 2 and 3 group (a) are required to report half-yearly, whereas categories 3 group (b) and 4 businesses are required to report quarterly. Stockbrokers (category 5) are required to report on a monthly basis in accordance with the Financial Supervision Commission (Stockbrokers) (No 2) Regulatory Code 2003. This requirement may be changed or supplemented for individual licenceholders by additional information (e.g., averages, or maximum/minimum figures) if the Commission considers such a requirement to be appropriate. For all except category 1 businesses, licenceholders are subject to specific audit requirements.

3.2.3 **This code should be read in conjunction with the [Financial Supervision Commission \(Clients' Money\) Regulations 1993](#) ("the Regulations") (see Appendix D1).**

Clients' Money ([Appendix C2](#))

One of the main purposes of this code and the Regulations is to provide for the protection of clients' money in the event of the insolvency of the licenceholder, i.e., to ensure that a liquidator is unable to claim clients' monies as part of the general assets of the licenceholder. Thus, a fundamental requirement is that clients' money should at all times be held in segregated and properly designated accounts on trust for the investor. The Commission requires bankers to provide confirmation that monies held in such accounts are not subject to any charge or lien, right of set-off, etc.

Additional safeguards have been included in the code for those situations where clients' money is paid into bank accounts abroad. In such circumstances, it is the responsibility of the licenceholder to ensure and demonstrate to the Commission that clients' money held in such accounts is afforded similar protection to that provided under the Commission's code and Regulations. If this cannot be done the licenceholder must warn the client in writing that his money may not be as well protected (see [Clients' Money Code 6.1 \(d\)](#)).

The other main aim of this code is to ensure that clients' monies are properly recorded, reconciled and controlled so that money belonging to one client is not utilised to meet the liabilities of either the licenceholder or another client. Special provisions are included for clients with a high volume of investment transactions and for those undertaking margined

transactions (e.g. futures).

The Commission does not require that interest earned on clients' accounts should be paid to clients but, if it is not, the Commission expects this to be clearly stated in a written agreement between the licenceholder and its client.

It is important to note that, for the purposes of this code, money held in an account in the name of the investor himself (i.e. not in the name of the licenceholder) is not clients' money, even where an individual working for the licenceholder is a signatory to the account because such money would not be at risk in the event of the liquidation of the licenceholder. However, this will be regarded as "control" of money belonging to clients, which may have implications for the categorisation of the licenceholder and related financial resource requirement. Other matters relating to such money re category 1 – 4 are addressed in the [Conduct of Business Code 5.5\(e\)](#) ([Appendix C4](#)).

3.2.4 Clients' Investments ([Appendix C3](#))

The principal objective of this code is to ensure that, where licenceholders have possession or control of investments belonging to others, adequate arrangements are maintained to ensure that such investments are kept safely and are properly recorded, identified, segregated and controlled so that at any time investments belonging to others are accounted for and no administrative or financial difficulties to which the licenceholder may be exposed would have adverse consequences for those clients or other persons. The code recognises that licenceholders may hold clients' title documents on a temporary basis while they are in transit to clients. In such circumstances, the code will not be applied as long as the title documents are registered in the name of the client and are forwarded to him within 2 business days.

The Code requires that a licenceholder must not recommend to a client that any other person should have custody of or should act as the registered holder of the client's investments unless that person is an "eligible custodian". An eligible custodian can be either an approved banking institution, a nominee company with no other business which acts solely in accordance with the directions or instructions of the licenceholder (in which case the nominee will be regulated through the licenceholder) or an institution providing custodial services in another territory which, in the opinion of the Commission, is adequately supervised by a regulatory body or Government agency in that territory. The licenceholder is responsible for ensuring that the custodian acknowledges in writing that the provisions of the code will be complied with by such custodians.

The Commission requires all licenceholders and any "eligible custodians" to maintain adequate insurance for non-registered securities which are in their possession at any time, against negligence, accidental loss, fire, flood, theft and employee fidelity.

The code also requires that written statements of investments held should be provided to each client normally twice a year after a complete reconciliation of clients' title documents has been carried out by the licenceholder and any "eligible custodians". In certain circumstances, the Commission is prepared to allow licenceholders to adopt a "rolling" basis of reconciliation. Before doing so, however, the Commission will require a report from the licenceholder's auditors on the adequacy of the licenceholder's system of internal controls for recording client investments.

3.2.5 This code describes the general principles and standard of conduct which the Commission expects licenceholders to adopt in their dealings with clients and others. Throughout the code, the distinction is drawn from time to time between the private investor (i.e. the man in the street) and the experienced or professional investor. All clients will be deemed to be private investors unless they have elected in writing not to be.

Conduct of Business ([Appendix C4](#))

The Commission considers that the private investor requires a greater level of protection than the experienced or professional investor and this is reflected in the code. Where no distinction is drawn, the Commission considers that a similar level of protection is appropriate for all types of client.

The code is self explanatory and is divided into 7 main headings:-

- i. integrity and fair dealing;
- ii. skill, care and diligence;
- iii. disclosure and information;
- iv. acting with agreement;
- v. responsible conduct;
- vi. futures, options and contracts for differences; and
- vii. documentation and records.

3.2.6 Audit Requirements ([Appendix C5](#))

This code requires that auditors of investment businesses (other than category 1 licenceholders) are restricted to those firms which are covered by professional indemnity insurance of not less than £10 million. The Commission also wishes to be satisfied that the firm has sufficient knowledge and expertise in this specialised area and that the partner in charge of the audit can demonstrate that he has adequate experience. The Commission also prefers the auditors of its licenceholders to have local representation in the Isle of Man.

The code lays down specific requirements for the letter of engagement between the licenceholder and its auditor. These requirements specify the rights and duties of the auditor and include a number of specific audit report requirements which are contained within the code. The code requires the auditor to make reports to the Commission in relation to the [Financial Resources Code](#), the [Clients' Money Code](#), the [Clients' Investments Code](#) and specific parts of the [Conduct of Business Code](#) and these reports play an important part in the effective enforcement of these codes.

3.2.7 General Requirements ([Appendix C6](#))

The overriding principle within this code is contained in paragraph 3 which states:-

"A licenceholder should co-operate in an open and honest manner with the Commission and any other regulatory body to which it is accountable and should keep them promptly informed of anything relevant to the Regulator's task."

Indeed, the Commission believes that compliance with this code is a substantive test of a licenceholder's continued fit and proper status and would not expect any licenceholder to have difficulty with it.

Dual Control ("four-eyes" control)

The code lays down several fundamental requirements, perhaps the most important of which is the requirement for the business of licenceholders within categories 2 to 4 to be conducted on a day-to-day basis by at least 2 individuals (the "four-eyes" principle). The Commission must be satisfied that the individuals proposed to fulfil the four-eyes requirement are competent and that they are people of integrity - but they must also have the maturity and strength of character to act with proper independence of mind. The Commission writes, as a matter of routine, to the individuals proposed by the licenceholder, describing its requirements and reminding them that failure to carry out their responsibility has implications for their "fit and proper" status (see [Appendix G3](#)). In order to appoint or replace an individual who forms part of the four-eyes control, the licenceholder must write to the Commission to recommend an appropriate individual. The Commission has the right to object to the person proposed.

The concept of four-eyes control seeks to prevent the day-to-day management of a licenceholder and its affairs being carried on under the influence of a dominant individual, whether that person is an owner, controller or a director.

The Commission requires, wherever possible, the persons responsible for the "4-eyes" not to be also responsible for

compliance matters.

This code also lays down certain notification requirements, some of which are, for obvious reasons, immediate ("forthwith") while others are designed to enable proper consideration and discussion to take place before a change is implemented. For example, 21 days notice must be given to the Commission prior to the appointment of any new director, manager, or secretary.

Category 1 licenceholders who are sole traders or small businesses must make arrangements to safeguard investors' interests in the event of death, illness, holidays etc. The code also lays down certain notification requirements, some of which are, for obvious reasons, immediate ("forthwith") while others are designed to enable proper consideration and discussion to take place before a change is implemented. Other paragraphs require licenceholders to obtain Commission approval before certain important changes are effected (e.g. acquisitions, mergers, etc).

Directors' responsibilities

The Commission is concerned to ensure that directors accept their responsibilities for the proper conduct and financial well-being of an Isle of Man licenceholder. Accordingly, the Commission has issued [Guidance Notes on the responsibilities and duties of directors under the laws of the Isle of Man](#)

Company Secretary

[The General Requirements Code 5](#) requires the company secretary of a licenceholder either to be properly qualified in accordance with section 19(4), paragraphs (a) to (e) of the Isle of Man Companies Act 1982 or, exceptionally, an individual who, by virtue of his knowledge and experience, is specifically approved by the Commission to act as company secretary.

Normally, the Commission would not expect the Managing Director of a licenceholder to also act as company secretary.

Compliance Officer

The Commission deems the person responsible for compliance matters (i.e. the Compliance Officer/Manager) a "manager" for the purposes of [General Requirements Code 7.2](#). Accordingly, it should be noted that the Commission must be appropriately notified of the appointment or resignation of the compliance person. The Commission also requires, wherever possible, the persons responsible for the day to day operation of the business of the licenceholder (i.e. the "4-eyes") should not be responsible for compliance matters.

Commission Approval

Other parts of the code require licenceholders to obtain Commission approval before certain important changes are effected (e.g. acquisitions, mergers, etc.).

3.2.8 Advertising ([Appendix C7](#))

The term "advertisement" is defined in the IBA as follows: -

"Every form of advertising whether in a publication or by the display of notices or by means of circulars or other documents or by an exhibition of photographs or cinematograph films or by way of sound broadcasting or television (including transmission by cable)."

This definition includes scheme particulars, prospectuses and any other offer documents.

The Commission does not require licenceholders to submit draft advertisements for approval prior to publication. However, this code lays down general principles relating to advertisements to which licenceholders should adhere.

The code is divided into two sections: -

- a. General Requirements. These are basic principles which apply to any advertisement. For example "an advertisement shall not contain a statement, promise or forecast which is untrue or misleading".
- b. Requirements relating to specific investments. These are designed to ensure that advertisements disclose adequately any special areas of risk in the investment product being advertised. In the case of advertisements inviting direct investment in futures, options and contracts for differences, a specific risk warning should be included as follows: -

"The risks of loss from investing in commodity and financial futures, foreign exchange contracts, securities and index contracts and options can be substantial".

This requirement is, of course, consistent with the Commission's requirements under the [Conduct of Business Code](#).

3.2.9 Stockbrokers ([Appendix C8](#))

This code is specifically for Category 5 licenceholders and covers all of the areas covered by the seven regulatory codes applicable to category 1 – 4 licenceholders ie. financial resources, clients' money, clients' investments, conduct of business, general requirements, advertising and audit requirements although the requirements may vary slightly.

3.3 "KNOW YOUR CUSTOMER"

Although the nature of a licenceholder's business is within the control of the Board and management, the Commission has long been aware of the risk of abuse of the Island's investment businesses by criminals. As long ago as 1985, the Commission introduced a "Know Your Customer" policy, designed to alert investment businesses to the dangers of doing business with people they did not know and of relying solely upon introductions from the marketplace. The Know Your Customer policy requires licenceholders to seek evidence of identity, to verify that identity, to enquire as to the nature of the business and activity of the customer and to monitor the activity of any doubtful accounts.

Since then, there have been numerous international initiatives to combat money laundering - the Basel Supervisors Committee introduced its Statement of Principles in December 1988; the G7 countries formed a Financial Action Task Force on money laundering in June 1989, which produced its Recommendations in April 1990; and in December 1990 the Joint Money Laundering Working Group in the UK produced its Guidance Notes for Banks and Building Societies. The Criminal Justice Act 1990, as amended, contains comprehensive provisions relating to the countering of "all-crimes" money laundering. The [Anti-Money Laundering Code](#), which came into force on 1 December 1998, applies to investment businesses and the Commission has produced [Anti-Money Laundering Guidance Notes](#) for its licenceholders.

Compliance with the Island's Anti-Money Laundering requirements is a requirement of the Commission's Conduct of Business Regulatory Code, as well as a recommendation pursuant to section 9 of the IBA.

3.4

COMPLIANCE PROCEDURES

[The Financial Supervision Commission \(Conduct of Business\) Regulatory Code](#) at [paragraph 6.7](#) states: -

"Compliance

A licenceholder should establish and maintain compliance procedures in writing where appropriate with a view to ensuring that: -

- a. its officers, employees and other representatives are aware of their obligations under the [Investment Business Act 1991](#) and any licence conditions, codes or regulations and are able to comply with them; and
- b. sufficient information is recorded and retained about the conduct of the licenceholder's business and its compliance with the [Investment Business Act 1991](#) and any licence binding upon it.

Compliance procedures should be in writing where the staff of the licenceholder exceeds ten.

A licenceholder should, at least annually, carry out a review of its compliance procedures to ensure that they are effective and have been complied with."

It is important that licenceholders are able to demonstrate compliance with all regulatory codes which impact upon them. The maintenance of comprehensive procedures and compliance manuals will assist licenceholders to evidence compliance with the above code and a review of such manuals will form a key part of supervisory visits.

Category 5 licenceholders should refer to codes 202-206 of the Financial Supervision Commission (Stockbrokers) (No 2) Regulatory Code 2003.

3.5 SUPERVISORY AND FOCUSED VISITS

The Commission's aim in conducting a programme of Supervisory and Focused Visits on its licenceholders is to promote high standards amongst those it regulates by identifying instances where investors or indeed, the licenceholder, may be at risk or where the standards and practices required by the Regulatory Codes are not being observed.

Specifically, the Supervision programme is to: -

- Assess whether those the Commission regulates remain fit and proper persons;
- Identify potential weaknesses in controls or procedures which may cause regulatory concern;
- Identify and investigate instances where investors' interests may be at risk from any failure to comply with the regulatory requirements;
- Assist those involved in investment business in understanding and meeting the Commission's requirements.

Commission's officers normally undertake supervisory visits on licenceholders at a pre-arranged time when the licenceholder is required to demonstrate that the requirements of the regulatory codes have been met. Reviews are not intended to be a comprehensive investigation of the licenceholder's activities. Whilst the Commission's Officers may suggest certain remedial actions and provide guidance where appropriate, it remains the ultimate responsibility of the licenceholder's Board to ensure the financial well-being and efficient management of the licenceholder, including compliance with the regulatory requirements and to protect the interests of shareholders.

Officers may conduct full Supervisory Visits, which extend to all activities carried on by the licenceholder, including any non-investment business and which will be undertaken over a number of days, or Focused Visits, concentrating on a particular area or areas such as [Know Your Customer](#) or [Clients' Money](#) which may be concluded in a shorter timescale.

It should be noted that the Commission's officers are bound by the strict rules of confidentiality laid down in sections 23 and 24 of the [Financial Supervision Act 1988](#).

SECTION 4

APPLICATION FOR AND RENEWAL OF INVESTMENT BUSINESS LICENCES

4.1 LICENCE APPLICATIONS

Copies of the Commission's application forms and other personal and bankers' questionnaires are available from the Commission's website. (Samples are contained in Appendices F and G, but please note that stockbrokers have a specific application form which applies solely to them, copies of this are available from the Commission's offices.)

The staff of the Commission are available to be consulted in the course of the preparation of an application for a licence and will try to give appropriate guidance where it is sought. However, in order that the role of the staff of the Commission is not misunderstood, the Commission wishes to emphasise that:-

- i. the preparation and submission of an application for a licence is the responsibility of the applicant;
- ii. the decision whether or not to issue a licence is the responsibility of the Board of the Commission; and
- iii. the Commission normally takes legal advice on questions of law that confront it and applicants for licences must similarly be prepared to seek legal advice on questions of law that confront them.

4.1.1 Consultation with Officers of the Commission

Prospective applicants are encouraged to approach officers of the Commission at an early stage to discuss their proposals for operating in the Isle of Man. These discussions enable the Commission's officers to give applicants any appropriate guidance where it is sought and to identify any foreseeable difficulties connected with the proposed operation. It also enables the Commission to assess the category of licence which the applicant will be required to hold and to advise on the Commission's financial resource requirements (see [Appendix C1](#)).

4.1.2 Consideration of the application by the Commission

The applicant will be notified at least 14 days in advance of the proposed Commission meeting at which the application will be considered, together with details of the proposed recommendations. The applicant may attend the Commission meeting with up to two other individuals who may be another executive of the applicant or an adviser.

If the application has a recommendation for refusal, then the applicant will be given the opportunity for an adjournment for legal representation.

Once the application has been considered, the Commission will announce its decision in writing, including if applicable any outstanding matters to be addressed before a licence will be issued. If an application is refused, the reasons for refusal will be stated and the rights of appeal in relation to the Commission's decision (ie to the Council of Ministers Review Committee) will be explained to the applicant.

It should be noted that the hearing of the licence application will be taped for note taking purposes only.

4.1.3 Appeals Process

Where the primary legislation provides a right of appeal from a decision of the Commission, any appeal will be to an independent Committee set up by the Council of Ministers, known as the Council of Ministers' Review Committee ("the Review Committee").

Any application for review must be sent in the first instance to the Chief Secretary who will report the application to the Council of Ministers. Upon notice of the application the Council of Ministers will then appoint a Review Committee made up of three members. The Review Committee will be entirely independent of the Commission and the members of each Review Committee will be appointed by the Council of Ministers from persons "of appropriate experience" who have no links to either the Commission or the applicant.

Upon determination of the issue in question the Review Committee must "confirm, vary or revoke" the decision of the Commission and, without prejudice to any right of recourse to the High Court, a decision of the Committee on a review will be binding on the Commission and the applicant.

4.1.4 Issue of Licence

Once the applicant has complied with all the Commission's conditions and requirements, the Executive reports this to the Board of the Commission for final approval and the issue of the investment business licence. Each investment business licence will specify the activity which the licenceholder has been licensed to undertake. The categories of investment business licence are defined in paragraphs 10 - 17 of the Financial Supervision Commission (Financial Resources and Financial Reporting) Regulatory Code 2002 (see [Appendix C1](#)) and as summarised in Table A of [Appendix 1](#) to the General Licensing Policy.

4.2 RENEWAL OF INVESTMENT BUSINESS LICENCES AND PAYMENT OF LICENCE FEES

Investment business licences are normally issued for an indefinite period, although a specific expiry date may be imposed in certain circumstances.

A non-refundable licence application fee is payable with a licence application and an annual licence fee is payable on issue of licence. In the first year, the annual licence is pro rata'd for the number of months remaining until the commencement of the next annual fee year. Thereafter, the annual fee is payable on 1 July each year (see [Section 6](#)). Fees may be paid by direct debit.

SECTION 5

E-COMMERCE AND REGULATION IN THE FINANCE SECTOR

The Commission is committed to applying international standards of regulation and supervision across all areas of its work, whilst also striving to maintain a level playing field with other jurisdictions. Indeed, its leadership in the regulation of offshore markets over many years has done much to enhance the Commission's reputation internationally.

The internet is a vitally important channel of distribution, especially for many Isle of Man institutions whose offshore clients can readily take advantage of the convenience provided by electronic commerce. The Electronic Transactions Act 2000, which came into force on 1st November 2000, provides an ideal platform for e-business to flourish on the Island, encouraging and facilitating the use of information technology by removing legal constraints affecting the use of electronic communications. Additionally, the pro-active stance of the [Isle of Man Government](#) contained within the Report by the Council of Ministers on the Government's E-commerce Strategy is of great benefit to Island businesses.

Against this background, the Commission recognises that a key aspect of confidence in the Island's attractiveness as an e-commerce centre is the regulatory approach to existing licenceholders who may be considering entering into e-business, and also to new e-business propositions.

In principle, the Commission's policy towards the licensing of banking and investment businesses remains the same whether for e-business or traditional business. However, as a relatively new medium, e-commerce has resulted in a change in focus to some of the traditional supervisory risk areas. Broad risk categories remain unaltered, but their importance and impact has changed dramatically. An example of this is systems dependency and security risk. To an Internet-based business, these risks have assumed very great significance.

The Commission has produced guidance notes for licenceholders and potential licenceholders, which can be found at [Appendix H](#), and which provide further detail on some of the risk areas and other relevant areas to which any financial business contemplating using the internet ought to give careful thought.

The Commission will ensure that its regulatory approach is realistic and pragmatic, at the same time as taking full account of international standards as they continue to evolve.

SECTION 6

FEES

When the Commission was established in 1983, Tynwald expressed the view that the expenses of the Commission should be covered by licence fee income. The Commission therefore sets its licence fees with a view to balancing its budget, and also having regard to equivalent fees in other jurisdictions.

The fees for investment businesses (with effect from 1st April 2005) are:-

1. Application Fees, to accompany every initial application for an investment business licence and will not be refundable if the application is unsuccessful:-
 - a. An application for a person to be licensed as a stockbroker (Category 5 investment businesses) - £1,450
 - b. All other investment business applications - £1,200
2. Annual Fees, payable by direct debit on 1 July each year:-
 - a. Category 1 investment businesses - £950
 - b. Category 2(a) and 3(a) investment businesses (except as specified in (d) and (e) below)- £3,200
 - c. Category 2(b) and 3(b) (except as specified in (d) and (e) below)- £4,300
 - d. Managers of collective investment schemes authorised under Section 3 of the Financial Supervision Act 1988 (category 2 or 3)- £6,600
 - e. Category 3 investment businesses which are administered by a third party fund administrator (except as specified in (b), (c) and (d) above)- £15,500
 - f. Third party fund administrators (category 4)- £6,400
 - g. Category 5(a) investment businesses- £2,850
 - h. Category 5(b) investment businesses- £6,600
 - i. Category 5(c) investment businesses- £13,200
3. Additional Fee for Managers of Collective Investment Schemes

This fee is payable upon the issue of a new licence following the addition of an international collective investment scheme to the licence of an existing manager. - £750

[SD 54/05](#) are the regulations covering fees in respect of investment business