

SM/02/83

March 14, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **Gibraltar—Publication of Offshore Financial Sector Assessments**

Attached for the information of the Executive Directors is the staff's assessment of the offshore financial sector of Gibraltar. The Managing Director has consented to a request by the authorities of Gibraltar to publish the assessment in accordance with the practices and procedures described in SM/01/228 (7/16/01). The posting of the assessment on the Fund's external website will be coordinated with its simultaneous release in Gibraltar.

Questions may be referred to Ms. Zephirin (ext. 38680) and Mr. Grant (ext. 39331).

Att: (1)

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Monetary and Exchange Affairs Department



GIBRALTAR

ASSESSMENT OF THE REGULATION AND SUPERVISION OF FINANCIAL SERVICES

October 2001

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PREFACE

On July 26, 2000, the Executive Board approved a program of assessments on the basis of a paper "Offshore Financial Centers—The Role of the IMF". In this context, the Government of Gibraltar invited the IMF to carry out an assessment in May 2001 of the extent to which the Gibraltar supervisory arrangements for the offshore financial sector complied with certain internationally accepted standards. The Gibraltar authorities indicated at the beginning of the assessment that they make no distinction in regulation and supervision between onshore and offshore activities. This assessment therefore covers both sectors. The assessment was carried out on the basis of the "Module 2" approach, as described in the above-mentioned paper.

The assessment was carried out by a team led by Mr. Neville Grant and including Ms. Yuri Kawakami (both Monetary and Exchange Affairs Department), Messrs. Ross Delston and John Austin (both Legal Department Consultants), Michael Deasy (Central Bank of Ireland), Ronald J. Ranochak (Formerly, Officer-in-Charge, United Nations Global Programme Against Money Laundering, Vienna), Steve Butterworth (Guernsey Financial Services Commission), Ronald E. Tompkins (Formerly Consultant, Fiduciary Services, Cayman Islands Monetary Authority). The report was typed by Ms. Marie-Carole St. Louis. The team received excellent cooperation from the staff of the Financial Services Commission, other authorities, and a number of private sector bodies.

I. EXECUTIVE SUMMARY

1. The development of the financial sector in Gibraltar has been facilitated by its location, a favorable tax regime, a stable government, status within the European Union (EU), no exchange controls, a legal framework based on the British system, and the availability of a well-qualified labor force, particularly well endowed with accounting and legal skills.
2. This assessment covers both offshore and onshore financial activities, as there is no difference in the regulation and supervision of onshore and offshore financial institutions. Regulation and supervision have been based on relevant EU legislation and reflect U.K. practices in these areas.
3. The Gibraltar financial sector is not large by international standards. For example, assets of banks that conduct only offshore business amount to £1.9 billion compared with Cyprus' £12 billion and Cayman's more than £450 billion. However, its contribution to employment and to the foreign exchange earnings of the economy is important. It is estimated that the financial sector, both onshore and offshore, accounts for roughly 30 percent of GDP or about the same as tourism.
4. The financial services provided are broad and include banking, insurance services, and some relatively small-scale fund management and advisory business. Current policy is that all such activities should be carried out in physical premises in Gibraltar, with accounting records and management available for inspection in the territory.
5. Banking is the most important offshore activity but with assets of US\$5 billion, it is small relative to that carried on in some other jurisdictions and does not create significant risk for the international financial system.
6. There are also a number of insurance companies whose total assets are about US\$325 million, and a modest investment and securities industry. In addition, there are approximately 28,500 active companies registered of which 8,800 are exempt companies. The provision of professional trusteeship and company management services is deemed to be "controlled activities" and there are 83 groups that are licensed to conduct that business.
7. The mission undertook a Module 2 assessment in accordance with the procedures agreed upon by the IMF's Executive Board in July 2000. This comprised a Basel Core Principles assessment of the supervision of the banking sector, an assessment of the insurance sector based on the International Association of Insurance Supervisors' (IAIS's) principles of insurance supervision, an assessment of the investment and securities business, based on the International Organization of Securities Commissions' (IOSCO's) principles, and an assessment of the provision of company and trust activities services.

8. With respect to the assessment of company and trust activities there are no agreed international standards. The OECD's Principles of Corporate Governance focus on the management of public companies. These principles are not applicable to trusts and are not directly applicable to privately held trading or holding companies which are typical in offshore jurisdictions. The assessment therefore is based on certain developing 'good practices' which have applied in the Edwards Report on Crown Dependencies and the KPMG Review of Financial Regulation in Caribbean Overseas Territories and Bermuda.

9. The results of our assessments indicated that supervision is generally effective and thorough and that Gibraltar ranks as a well-developed supervisor. It meets most of the international standards and 'good practices' and is making considerable progress with respect to those principles with which it is not yet fully compliant or observant.

10. There is a high level of compliance with the Basel Core Principles for Effective Banking Supervision. Gibraltar is compliant with 18 of the principles and largely compliant with the other seven.

11. Insurance is also supervised to a good standard. Gibraltar is observant of 13 of the Core Principles promulgated by the IAIS, largely observant of three others and materially non-observant of one. The latter relates to onsite visits and Gibraltar is aware of this weakness.

12. With regard to the regulation and supervision of investment and securities activities, Gibraltar was assessed with respect to the 30 IOSCO principles and is fully compliant with 19, largely compliant with three and eight are not applicable.

13. In the area of company and trust regulation and the supervision of company and trust service providers, where there are no international standards, as yet, Gibraltar is in the forefront of the development of good practices. It is worth noting that Gibraltar was one of the first jurisdictions to have introduced regulation and supervision of the company and trust services business

14. In 1989, the Government of Gibraltar introduced the Financial Services Commission Ordinance which was enacted in Gibraltar's Parliament. Whilst overall policy in respect of financial services remain within the remit of the government, the Ordinance established a Commission that is fully independent of the Government of Gibraltar in regulatory and supervisory matters. The Ordinance provides for appointment of the Commissioner also Chairman of the Financial Services Commission—and the seven other members to be made by the Governor (acting with the agreement of the U.K. Foreign Secretary). The Ordinance also requires the Financial Services Commission (FSC) to provide advice to the Government of Gibraltar on the regulatory aspects of financial services matters and, in practice, this has meant that the FSC and the Government have established a close working relationship. The promotion of Gibraltar as a financial center is the responsibility of the Gibraltar Finance Center Division within the Ministry of Trade, Industry and Telecommunications.

15. The FSC is the sole regulatory and supervisory authority for financial services providers operating in or from within Gibraltar. Under its founding ordinance, the FSC is required to match U.K. supervisory standards where European Union law applies and as Gibraltar is part of the European Union through the United Kingdom's membership, it has put in place relevant EU directives that apply to the financial sector.

16. The FSC carries out its duties diligently and has an intimate knowledge of the institutions under its supervision. Its policy is to be approachable and accessible to its licensees and this is characteristic of small jurisdictions where people are well known to each other. There is general acknowledgement in the industry of the FSC's professional approach.

17. There is some scarcity of resources, and this has meant that the amount of onsite supervision has been somewhat less than desirable. The FSC is aware of these limitations and is making efforts to resolve them. The issue of additional resources is one that is faced by many jurisdictions. This is a result of the demand internationally for more and better supervision.

18. The FSC's activities are supported by a well-developed Information Technology (IT) system that provides a wide range of timely management information. This facilitates peer group analysis, trends and exception reports.

19. Current anti-money laundering measures as they relate to the Basel Core Principles, the IOSCO Principles and the IAIS Principles appear to be effective, although as in other jurisdictions, there is always scope for improving know your customer requirements. The FSC complies with accepted international standards of cooperation with foreign supervisory agencies with regards to the exchange of information and allows foreign home supervisors to conduct onsite reviews in Gibraltar.

II. BACKGROUND

A. Macroeconomic Developments

20. Gibraltar has been part of Her Majesty's Dominions since 1704, and is currently an overseas territory of the United Kingdom.¹ Today it is self-governing except for police, defense, and foreign affairs. It is small in size (6.5 square kilometers) and population (30,000). The economy was traditionally developed by providing services to the Ministry of Defense, which in 1984 accounted for some 60 percent of the economy. The British military presence was sharply scaled down over the past 16 years, and Gibraltar has succeeded in transforming its economy through diversification. Tourism, shipping, and finance have become the mainstays, each accounting for roughly 25–30 percent of the GDP. The

¹ The Treaty of Utrecht in 1713 ceded the Rock to the Crown in perpetuity. In a 1967 referendum, Gibraltarians voted to remain a British territory.

telecommunications sector has grown into a fourth pillar, constituting 10 percent of the economy, while the dependence on the military base has been substantially reduced to less than 10 percent (Box 1).² Gibraltar has low unemployment and inflation, both hovering at around 2 percent in recent years.

21. Gibraltar has been part of the European Union since 1973 under the U.K. Treaty of Accession. Article 28 of the Act of Accession granted three exemptions from complying with the European Community rules: common customs tariff, common agricultural policy, and harmonization of turnover taxes, notably the value added tax (VAT).

22. The government has conducted a conservative fiscal policy. Overall fiscal balance under the FY2000(July-June) budget is projected at £16 million, while public debt stood at £71 million as of March 2000. There is no capital gains tax, wealth tax, inheritance tax, estate duty or VAT, and there are no exchange control restrictions.³ The corporate tax rate is set at 35 percent. However, tax exempt companies pay no tax other than a flat rate of £200-300 a year, and qualifying companies are subject to a prescribed tax rate usually set at 5-10 percent. Tax exempt or qualifying companies cannot have Gibraltarians or residents as their beneficial owners,⁴ and cannot conduct business with residents. Among the 28,500 active companies, some 8,800 have tax exempt status, and do not have a physical presence in Gibraltar. Many of them are asset or property holding companies. There are 146 qualifying companies, all of which have a physical presence in Gibraltar.

23. The trade deficit in 2000 widened to £241 million from £167 million in 1997,⁵ owing to rising imports (fuels, manufactured goods and processed foods) mainly from the United Kingdom and Spain.

² The authorities are awaiting the result of a commissioned input/output study, in which the GDP statistics are being reviewed. Shortage of labor is not considered as a major concern, since EU nationals can work in Gibraltar under EU protocols without the need for work permits.

³ The income tax rate is high by international standards, set at 50 percent of taxable income exceeding £19,500, although there are housing, pension, and insurance allowances. Three quarters of tax revenue is generated by income tax, while corporate tax constitutes about 18 percent of tax revenue.

⁴ The Finance Center Division is responsible for granting tax exempt or qualifying status, and obtains information on the beneficial owners on application.

⁵ The export data exclude petroleum products bunkered to vessels. See Box 1 for information regarding bunkering.

Box 1. Gibraltar: Diversification of the Economy

Tourism accounts for about 30 percent of GDP. Sectors such as retailers, hotels and restaurants are heavily tourism oriented, and employ well over 3,000 people out of the total employment estimated at 13,500 in 2001. Tourism expenditures in Gibraltar were estimated at £162 million in 2000, and about 85 percent was spent by day excursionists from Spain. Among the land arrivals that reached 7 million in 2000, 4.5 million were estimated to be tourists. Cruise ship calls and hotel occupancies also point to booming tourism.

Shipping accounts for about 30 percent of GDP. Over 6,300 vessels including 175 cruise liners called the port in 2000, soaring by 40 percent compared with 1996. Gibraltar is the largest bunkering port in the Mediterranean, and one of the largest in the world, providing 2.7 million tons of fuel to vessels. The port also caters to ship repairment needs.

Finance services account for about 25 percent of GDP. Financial institutions employ 2,200 people, with the share of expatriates about 15 percent. (See Chapter B for details on the financial sector.)

Telecommunications account for about 10 percent of GDP. Gibraltar has two local telecommunications companies, owned partly by the government. Two more telecommunications companies have recently invested in Gibraltar, which includes an establishment of a satellite control center in the Rock that channels intercontinental telecom traffics.

The government is promoting Gibraltar as an e-commerce base. An offshore gaming industry—internet and telephone betting placed by nonresidents—has rapidly grown in recent years, aided by a low gaming tax. The industry has accelerated growth in telecommunications, and employs 630 people.

24. Gibraltar has traditionally had a very small financial sector. A rapid expansion in numbers and type of financial business started in the mid-1980s, triggered by the opening of the border with Spain. Gibraltar's offshore financial business dates back to the enactment of the Companies (Taxation and Concessions) Ordinance in 1967, which made provision for the tax exempt status for offshore businesses. The Income Tax Ordinance in the early 1980s made provision for the qualifying status for offshore business. Financial institutions can apply for tax exempt or qualifying status, provided that they satisfy the eligibility criteria aforementioned. The development of the financial sector has been facilitated by its location, a favorable tax regime, a stable government and status within the European Union, no exchange controls, a legal framework based on the British system, and the availability of competent legal and accounting services. However, the size of the offshore financial business remains very small relative to other major offshore centers.

Table 1. Gibraltar: Number of Licensed or Authorized Firms, 1998-2001
(At end-March)

	1998	1999	2000	2001
Banks	28	26	22	19
Insurance companies	16	16	13	18
Insurance	4	8	7	7
Insurance	17	22	24	27
Investment	11	17	27	28
Company managers/professional	75	81	84	83

Source: Financial Services

1/ The number for 2001 is as of May 2001. Data refer only to those licensed Insurance Companies Ordinance 1987. In addition, seven companies from the Economic Area (EEA) have branches in Gibraltar.

B. Financial Sector

Banking

25. As of May 2001, there were 19 licensed or authorized banks in Gibraltar, down from 28 in 1998, owing to mergers and other business reasons. Ten banks are incorporated in Gibraltar, and are licensed and subject to comprehensive supervision by the FSC. Seven banks are branches of banks operating in Gibraltar under the terms of their EU home country authorizations. These banks are not licensed by the FSC, but are subject to supervision limited to liquidity. Two banks are branches of non-EEA banks—one from Jersey, and the other from the Isle of Man—and are licensed and subject to comprehensive supervision by the FSC except for the calculation of capital and large exposures as branches do not have capital.

26. The total assets of the 19 banks were £5.2 billion as of April 2001 (Table 2). Eleven banks are offshore banks that serve only nonresidents, and their total assets were £1.9 billion. (The offshore sector is small compared with other countries such as Cyprus, where assets of

banks conducting solely offshore business is estimated at £12 billion and the Cayman Islands' more than £450 billion. The other eight banks do a mixture of local retail and offshore business, and their total assets were £3.3 billion. The total size of off-balance sheet items for all banks were £49.2 million. The total assets under management by all banks were £5.9 billion. The Banking Ordinance 1992 removed the difference in the regulatory treatment of offshore and onshore banks (see Section IV for further details on banking).

Table 2. Gibraltar: Assets and Liabilities of
(In billions of

Assets		Liabilities	
Cash	0.0	Deposits	2.5
Balances with	3.9	Balances from	1.7
Loans	1.2	Capital	0.9
Investment	0.0	Other	0.1
Other	0.1		
Total	5.2	Total	5.2

Source: Financial Services

Insurance

27. There are 18 insurance companies licensed and supervised by the FSC as of May 2001 under the Insurance Companies Ordinance 1987. Only two are active in the local market covering risks situated in Gibraltar, while the other 16 companies are mainly conducting offshore business in captives⁶ and reinsurance. The captive companies are managed by insurance company managers who are licensed under the Financial Services Ordinance 1989. There are currently seven licensed insurance managers. In addition, there are seven insurance companies from the EEA that have branches in Gibraltar. These companies are neither licensed nor supervised by the FSC. The gross premium income written by all Gibraltar insurers was some £70 million.

28. There are 10 Gibraltar insurers that provide insurance services into the EEA member countries as of May 2001 (see Section V for further details on insurance).

⁶ Captive insurers primarily cover the risks of the parent or affiliated companies.

Investment services

29. The investment services sector consists of two sub-sectors. Insurance intermediaries mainly cater to residents' needs for family protection and investment, and general insurance, while investment firms mainly provide financial services such as portfolio management to nonresidents. There were 27 insurance intermediaries and 28 investment firms as of March 2001 (see Section VI for further details on investment services).

Controlled activities

30. Controlled activities in Gibraltar refer to the trust and company management services. As of March 2001, there were 83 groups licensed to carry on controlled activities business, and 47 of them were licensed to act as professional trustees. The licensed groups comprise accounting firms, law firms, and firms providing a variety of financial services business. Gibraltar has pioneered the regulation and supervision in this sector, pursuant to the Financial Services Ordinance 1989 and the Financial Services Commission Ordinance 1989 (see Section VII for further details on controlled activities).

C. Regulatory and Supervisory Framework of the Financial Sector

Regulatory and supervisory authorities

31. The Financial Services Commission (FSC), is the sole regulatory and supervisory authority for the financial services providers operating in or from within Gibraltar, including banks, insurance companies, insurance company managers, investment firms, insurance intermediaries, and company managers and professional trustees. This is achieved through the role of the Commissioner who is responsible under the various individual financial services ordinances for the regulation and supervision of the above mentioned sectors.

32. Since Gibraltar is part of the European Union through the United Kingdom's membership, Gibraltar has put in place relevant EU Directives that apply to the financial sector. Also, the FSC is statutorily obliged under its founding Financial Services Commission Ordinance 1989⁷ to match U.K. supervisory standards where EU legislation applies; standards that must be reviewed by the U.K. authorities. The FSC has no responsibility to promote Gibraltar as a financial center. Primary responsibility for promotion of the financial center falls under the Department of Trade, Industry, and Telecommunications and its

⁷ The FSC Ordinance 1989 came into effect in January 1991.

Minister who is also responsible for government policy for financial services.⁸ The Financial Center Division established in 1997 is part of the Department.

Laws governing the financial sector

33. The financial sector is governed by various ordinances (primary legislation), regulations, and administrative notes and guidance notes, and the relevant supervisory legislation is readily available from the web site of the FSC. Major ordinances concerning the financial sector include the Companies Ordinance, the Income Tax Ordinance, the Financial Services Ordinances 1989 and 1998, the Financial Services Commission Ordinance 1989, the Banking Ordinance 1992,⁹ the Insurance Companies Ordinance 1987, the Trustee Ordinance, the Drug Trafficking Offences Ordinance 1995, and the Criminal Justice Ordinance 1995.

D. Prior External Assessments of the Financial Sector

34. Gibraltar has received several assessments of its financial sector in recent years. The main findings of prior assessments are summarized below.

Reviews by the United Kingdom's authorities¹⁰

35. The FSC is statutorily obliged under its founding FSC Ordinance to match U.K. supervisory standards, where EU legislation applies, and the Ordinance provides for review by the U.K. authorities. Two reviews have been completed. The first review in April 1997 assessed all operations of the FSC, while the second review in spring 1998 focused on the FSC's banking supervisory operations. The first review found that "the insurance supervision function in Gibraltar can be regarded as up and running and matching U.K. standards," while, in bank supervision, "work...remains to be done to bring it up to U.K. standards." This review made recommendations for areas in which the FSC did not match U.K. standards. The second review concluded that "the FSC had addressed all of the recommendations from the first review." A third interim review was conducted in 1999 on investment services, raising technical issues that need to be resolved.

⁸ The Finance Center Division is charged with marketing, strategic planning, product development and training initiatives, and acts as the first point of contact for new financial businesses. It is also responsible for granting tax exempt or qualifying status to applicants.

⁹ The Banking Ordinance 1992 gave effect to the EU Banking Directives which provided the FSC with the power to issue administrative notices to transpose Community obligations.

¹⁰ The FSC noted in its *Annual Report 2000* that these reviews were "rather different from, and certainly less public than, for instance, the Edwards Review of the Channel Islands and the Isle of Man, or the KPMG Review of the Caribbean Overseas Territories and Bermuda. The process of external and independent validation of standards is the same."

Financial Stability Forum

36. Subsequent to publication of its report on Offshore Financial Centers (OFCs) in relation to global financial stability (April 5, 2000), the Financial Stability Forum (FSF) published in May 26, 2000 a categorization of OFCs “reflecting their perceived quality of supervision and perceived degree of cooperation.” The FSF included Gibraltar in Group II, comprising “jurisdictions generally perceived as having legal infrastructures and supervisory practices, and/or a level of resources devoted to supervision and cooperation relative to the size of their financial activities and/or a level of cooperation that were largely of a higher quality than Group III but lower than Group I.”¹¹

Financial Action Task Force

37. The Financial Action Task Force on Money Laundering (FATF) assessed 29 jurisdictions and identified 15 jurisdictions as non-cooperative in the fight against money laundering in a report issued on June 22, 2000. The FATF found that Gibraltar had a comprehensive anti-money laundering system, and did not classify Gibraltar as an uncooperative jurisdiction. In April 2001, the FSC received an FATF team under the auspices of the OGBS that conducted a mutual assessment, for which the FSC is awaiting a report.

E. OECD List of Tax Havens

38. Gibraltar was listed in the OECD List of Tax Havens (June 26, 2000). Part II of the OECD report reviewed non-member jurisdictions against certain fiscal principles. Part I of the OECD report listed harmful tax practices within OECD jurisdictions. Gibraltar is considering making a commitment to the OECD by the deadline, subject to the needs that the OECD has recognized of ensuring that global compliance with agreed upon fiscal standards would maximize global financial stability.¹²

¹¹ The FSF stated in its press release of May 26, 2000, that “it is important to stress that the categorization of OFCs into these three groupings is based on responses of OFC supervisors and the impressions of a wide range of onshore supervisors at a particular point in time. The categorization does not constitute judgments about any jurisdiction’s adherence to international standards.” The Gibraltar authorities felt that the process was poor and not objective.

¹² The Gibraltar authorities are of the view that there is no validity in the distinction between offshore and onshore regulations and supervision, and they are willing to meet international standards that create a level playing field for all financial centers.

III. ASSESSMENT OF GENERAL ISSUES

39. This chapter reviews issues that cut across all financial sectors, and therefore are assessed separately.

A. Responsibilities, Independence, and Resources

Responsibilities and independence

40. The FSC is the sole regulatory and supervisory authority of the financial sector in Gibraltar, including banks, insurance companies, insurance company managers, investment firms, insurance intermediaries, and company managers and professional trustees. The responsibilities of the FSC are to carry out the functions set out in Section 6 of its founding Financial Services Commission Ordinance 1989 (FSCO 89), and other relevant ordinances and regulations (see Section II, Chapter C for major legislation). The FSC plays no role in the marketing of Gibraltar as a financial center, which is the responsibility of the Department of Trade, Industry, and Telecommunications and its Minister.

41. Although overall responsibility for financial services rests with the Government, the Governor of Gibraltar, acting with the agreement of the U.K. Foreign Secretary, appoints the Commissioner of the FSC—also the Chairman of the Commission—as well as seven other members of the Commission.¹³ The FSC is fully independent of the Government of Gibraltar. In practice, the FSC's daily supervision is fully discharged by its staff, however, the FSC liaises well with the government and consults with industry and government when making changes to broad regulating policy or changes that have significant implications for industry. The Commission is obliged to submit an annual report and its accounts to the relevant government minister, who, in turn, is obliged to lay the report and the accounts before the House of Assembly, pursuant to the FSCO 89.

Resources

42. The FSC currently employs 15 people, eight of them professional staff, with one or two each dedicated to banking supervision, insurance supervision, investment services supervision, controlled activities supervision, and internal financial accounting. Two professionals are qualified accountants, and four others hold university degrees. There is a general need for additional capacity for analytical and enforcement staff, and the FSC has already recognized the need, and are considering that the recruitment of more professionals to assist in all the supervisory areas would be an asset. The evaluation of these needs are discussed in Sections IV-VII. Many jurisdictions face this problem of requiring additional

¹³ Members of the Commission are all non-executives. The Commissioner is the executive officer. Board meetings are held four times a year at the FSC.

personnel since the increased levels of supervisory performance generally demand more supervisors.

43. The FSC is funding its operations mainly through the fees that it charges licensees. There have been shortfalls in recent years, owing mainly to rising overhead costs to recruit, develop, and retain staff, which has been met by financial assistance from the Government of Gibraltar since FY1997 (April – March), accounting for 15–20 percent of the FSC budget. The FSC has received a letter of comfort from the Government of Gibraltar each year in March since the subvention started. To enhance the basis for self funding, the FSC has proposed a change in the fee regulation that has remained unchanged for a decade. The new proposal is being discussed with the private sector, and is expected to be considered first by the government; thereafter agreed upon changes will be introduced.

B. Cross-Border Cooperation

44. The FSC complies with accepted international standards for cooperation with foreign supervisory agencies with regards to the exchange of information. The exchange of information between the FSC and foreign supervisor is generally provided for under Section 22 of the Financial Services Commission Ordinance, and, more specifically, under Subsection 82(10) and Sections 60A, 61, 86A and Schedule 3 of the Banking Ordinance,¹⁴ as well as Schedule 16 of the Insurance Ordinance and Section 58 of the Financial Services Ordinance 1989. There is no-exclusion in the scope of information that can be exchanged. The exchange of information with the other EEA supervisors is governed by various EU directives transposed into Ordinances. Confidential information on banks can only be disclosed to foreign supervisors meeting the EEA standards. The FSC is also satisfied that the United States, Switzerland, Jersey, Guernsey, and the Isle of Man meet these standards.

45. The FSC allows foreign home supervisors to conduct onsite reviews in Gibraltar. Onsite reviews have been conducted by the banking supervisors from Denmark and from the United States when U.S. banks were operating from Gibraltar.

46. The FSC signed a Mutual Assistance Agreement with the London Stock Exchange (LSE) in June 1996 regarding exchange of information on members of LSE conducting investment business in Gibraltar. Also, the FSC signed a Memorandum of Understanding (MOU) with the Jersey FSC regarding exchange of information on banks in October 1998,¹⁵ and with the London International Financial Futures and Options Exchange (LIFFE) in

¹⁴ While Section 86A of the Banking Ordinance 1992 provides for the exchange of information on consolidated supervision, there are no internationally active banking groups for which the FSC has the responsibility of consolidated supervision.

¹⁵ The FSC signed an MOU with the Bank of England in 1995, but has not yet negotiated one with the FSA yet. The FSC is in discussions with the Isle of Man about signing an MOU regarding the exchange of information on banking.

August 1998 regarding exchange of information on members of the LIFFE incorporated in Gibraltar. These memoranda of agreement describe the scope of information to be exchanged along with their confidentiality.

47. The FSC is a member of international groups, including the IAIS, the Offshore Group of Insurance Supervisors (OGIS), and the Offshore Group of Banking Supervisors (OGBS).¹⁶ The FSC sends its staff to international seminars in which supervisory issues are discussed, and has close contacts with the Financial Services Authority in the United Kingdom.

C. Enforcement Remedies

48. The matter of enforcement remedies available to the FSC was discussed extensively during the mission. These remedies are adequate for most purposes. The mission pointed out that, as a general rule, regulators are well served when they have the broadest possible array of enforcement tools at their disposal—even if some of the more robust remedies are most often held in reserve, or are used only in special cases. The mere availability of certain remedies is often sufficient to deter wrongdoers. In addition, in order to be fully effective in dealing with unexpected problems, the enforcement remedies must be in place before the need for them arises. One issue that was explored extensively was civil money penalties.

Civil Money Penalties

49. The FSC has adopted regulations that provide authority for the imposition of civil money penalties (penalty fees) for violations by licensees of any provision of FSO 89 and regulations adopted there-under; however, the regulatory infractions that are listed on the schedule attached to the Penalty Fees Regulation suggests that they will be applied principally for relatively minor infractions. These include the failure to file required forms and notices on a timely basis, and the failure to display a license, although a few more serious offenses, such as the failure to contain the business conducted within the terms of the license are listed. The penalties appear to be low and are stated as flat amounts. Because civil money penalties are not criminal sanctions, they may be imposed more speedily and without reference to many of the procedural requirements applicable to the use of criminal sanctions; indeed, the mere availability of a credible threat of civil money penalties can deter potential wrongdoers.

¹⁶ The FSC hosts the Internet site for the OGIS. The FSC hosted a joint meeting of the OGIS and the OGBS in June 2001. The Gibraltar Financial Intelligence Unit has sought membership in the Egmont Group of Financial Intelligence since 1997, but membership has not been provided due to political objections from Spain.

Recommendation

The FSC should consider a regime of penalty fees for all sectors that would provide more flexibility for the FSC to impose penalties at its discretion and in amounts high enough to serve as a deterrent for all for serious violations of law or regulation. This would be without prejudice to other sanctions as applicable in accordance with law. The licensee would continue under current law to have recourse to the courts.

Suspension or removal of certain persons

50. The FSC's enforcement powers in some matters are indirect, for example, the suspension or the removal of executive officers of a licensed entity, the removal of external auditors of insurance companies and the appointment of a temporary administrator for troubled insurance companies. The clarification of those powers and their application would benefit both the FSC and the supervised institutions.

51. The ability to remove an officer or director who is causing damage to a licensee, and to suspend such an individual for a temporary period when the need for action is urgent, are important supervisory tools. Similarly, the appointment of a temporary administrator for a troubled institution for a period of time can prevent dissipation of assets and provide the opportunity for the regulator to assess options to deal with the institution's problems.

52. Persons who are the subject of enforcement action sometimes challenge its authority. As a result, enforcement remedies should not rely on indirect methods, or implied powers – such as the threat of license revocation – but instead should reflect a specific and clear grant of enforcement authority by the legislature to the regulator. While current law may indirectly provide such authority, the removal authority would be more likely to survive challenge if it were set forth explicitly, rather than being derived by implication.

Recommendation

The FSC should consider seeking the explicit legal power, exercisable in the appropriate circumstances, to suspend on a temporary basis any officer or director of a regulated entity; to permanently remove such an individual; and, in appropriate cases, to bar an individual from working in the financial services industry for a period of time.

D. Prudential Aspects of Anti-Money Laundering Efforts

Introduction

53. The assessment of Gibraltar's anti-money laundering regime in this report relates primarily to those standards contained in the Basel Core Principles, the IOSCO Principles and the IAIS Principles. As indicated earlier, the FATF found that Gibraltar had a comprehensive anti-money laundering system. The following comments and recommendations are intended to improve the system.

Legislation

54. Gibraltar's anti-money laundering legislation, which is modeled on that of the United Kingdom, consists of the Drug Trafficking Offences Ordinance 1995 ("DTO") and the Criminal Justice Ordinance 1995 ("CJO"). There are also Anti-Money Laundering Guidance Notes (March 2000, amended June 2000) (hereinafter the "AMLGN") that have been issued by the FSC pursuant to the CJO. The CJO has the stated intention of transposing into Gibraltar law the EU anti-money laundering directive, Council Directive 91/308/EEC.

Anti-Money Laundering Guidance Notes

55. The AMLGN have been adopted by the trade and representative organizations in Gibraltar that represent all of the activities regulated by the FSC, and, under the CJO, may be taken into account by a court in determining whether a person charged with a crime has complied with the requirements of the CJO. In addition, the FSC has issued a Best Market Practice Newsletter stating that compliance with the AMLGN was a "continuous condition for a license" to all institutions licensed under the Financial Services Ordinance, such as general insurance intermediaries and company and trust services providers, that were not covered by the CJO. The AMLGN are based upon guidance notes issued in the United Kingdom by the Bankers Association for their members and endorsed by the U.K. regulatory authorities. One of the focal points of the AMLGN are the "Know-your-customer" (KYC) requirements, particularly in Part IV, which, require particular attention to ensure that best practices have been met.

56. The provisions dealing with postal, coupon, telephone and internet business [4.42–4.51; 4.70 and CJO 12] should be revisited to explore ways to tighten identification procedures for opening new accounts. In addition, the provisions dealing with Client Accounts Opened by Intermediaries [4.92–4.109 and CJO 13] deal with KYC requirements involving intermediaries from EU countries and equivalent countries. In particular, concerns arise with respect to relying on intermediaries or introducers in lieu of the institution in Gibraltar conducting its own KYC diligence. While practices similar to these may be found in EU countries and in other jurisdictions as well, the authorities should be aware that approaches such as these may have the effect of creating increased money laundering risks.

Recommendations

Given their legal significance, as outlined above, the review of the AMLGN that is contemplated by the Consultation Paper on Amendments to Gibraltar's Anti-Money Laundering Regime (March 1, 2001) should include, but not be limited to, the following:

- The use of terms such as "recommended" [Sec. 3.06], "strongly recommended" [4.04] "should" and "would" [4.11, 4.30, 4.43], "ideally" [4.10], and "may wish" [3.06], suggests that the action is not mandatory and therefore may provide a defense to a criminal defendant who has not complied with the CJO. The use of these terms should be reviewed to determine if "shall" or a comparable term would be more appropriate to indicate that the action is required and not discretionary on the part of the institution.
- The FSC should make the AMLGN available on its web site, along with the amendments and consultation paper that are currently posted.

Consultation Paper on Amendments to Gibraltar's Anti-Money Laundering Regime (March 1, 2001)

57. The FSC has issued a Consultation Paper on Amendments to Gibraltar's Anti-Money Laundering Regime (March 1, 2001) containing four recommendations primarily relating to updating the KYC requirements of Gibraltar laws and the AMLGN, in part responding to concerns raised by the FATF in its June 2000 report on the use of these and other practices internationally.

58. There remain a few areas where the Consultation Paper endorses practices that are found in EU countries but the effect may be to allow Gibraltar institutions to rely on introducers to take steps that the Gibraltar institution would otherwise be required to perform. For example, Recommendation No.1 would amend Part IV of the AMLGN to permit an institution "to rely upon copies of due diligence documentation provided by an introducer." A similar issue also arises with respect to Recommendation No. 4 of the Consultation Paper, which refers to verification of KYC documentation by introducers meeting certain criteria. The statutory basis for these practices is found in Sec. 13 of the CJO. While practices similar to these may be found in EU countries as well as in other jurisdictions, the authorities should be aware that approaches such as these may have the effect of creating increased money laundering risks.

Recommendations

In general, the Consultation Paper recommendations are a response to the concerns raised by the June 2000 FATF report, but the following issues should be clarified, as follows:

With respect to Recommendation No. 4, the reference in the second bullet to permitting “an institution’s management to signing off individual documentation requirements as having been met for business relationships...where the relationship is of such a nature as to make the obtaining of such documentation unnecessary” should be revisited, since this citation. This could be used as an all-purpose exemption from the KYC requirements for institutions not wishing to disturb their customers. At a minimum, (i) a reference to the criminal offense provisions of Sec. 10(1) of the CJO, which refers to a money laundering offense that has been committed with the *consent* of a director or officer, should be included in the AMLGN; (ii) the sign-off should be characterized as a consent under Sec. 10(1) of the CJO in order to tie the sign-off more closely to the CJO; and (iii) some conditions to the management sign-off should be added to the AMLGN to avoid the sign-off process from being used as the primary method of complying with the requirements.

Gibraltar Financial Intelligence Unit (GFIU)

59. Financial intelligence units (FIU’s) are not explicitly mentioned in the Basel Core Principles (BCP), the IOSCO and the IAIS principles. However, in the BCP methodology, criterion one refers to “reporting of such suspected activities to the appropriate authorities.” The receipt and use of suspicious activity reports is one of the primary functions of an FIU, and the effective follow up of suspicious activities is an important link in strengthening the prudential aspects of anti-money laundering efforts.

60. The GFIU has an intelligence gathering and analysis function and provides suspicious transaction reports to the Royal Gibraltar Police (RGP) and Gibraltar Customs. The GFIU is a two-person unit in a larger entity known as the Gibraltar Co-ordinating Center for Criminal Intelligence & Drugs (“GCID”), which has an additional five individuals, all seven of whom have been seconded from either the RGP or Gibraltar Customs. Of the two individuals at the GFIU, one has three months experience, the other three years, and the Head of the GCID has six months experience. The GCID Head reports both to the Chief Minister of the Government and to the Governor. The actual task of following up the reports is for the RGP and customs.

61. The GFIU received 216 suspicious transaction reports in 2000, of which about 70 percent were from banks, 9 percent from telecommunications, 6 percent from money transmission services, 5 percent from company management and 4 percent from bureaux de change. Within the financial sector, the number of reports varies widely. In about 98 percent of the reports, no criminal offense was determined, and only 1 percent of the reports directly lead to an arrest or conviction on money laundering or other offenses. While these statistics do not necessarily reflect levels of compliance, they could reveal differences in compliance within the financial sector that should be followed up with additional training and publicity provided by the GFIU and the FSC.

62. Our terms of reference did not require us to conduct an in-depth assessment of all of the activities of the FIU. However, it appears on the basis of the information in the two

paragraphs above that the authorities should consider providing more staff to the FIU so as to improve its effectiveness. In addition, since some expertise is needed in computer and financial analysis and investigative skills, and given the learning curve involved in financial investigations work, consideration might also be given to the retention of a cadre of career employees.

E. Legal/Policy Development Officer

63. Consideration should be given by the FSC to employing an attorney on its staff. Although the Commission has had an in-house attorney in the past, in the last two years it has relied on the services of a number of private firms. The tasks of the legal/policy development officer could include the drafting of legislation, regulations and guidance notes; initiation of enforcement actions and the prosecution or defense of any litigation associated therewith; acting as secretary to the board of the FSC, including the drafting of board resolutions and U.K. initiatives with a view to implementing them in Gibraltar; and policy development and analysis in connection with the work of the FSC.

64. During the coming year, the drafting of amendments to current legislation administered by the FSC as well as a revision of the Anti-Money Laundering Guidance Notes will be necessary. The hiring of a legal/policy development officer would free up the time of operations staff. This arrangement would still leave the FSC with the option of retaining outside counsel in cases involving specialized or complex matters.

IV. ASSESSMENT OF BANKING STANDARDS

A. Introduction

65. The banking sector is comprised of 19 banks, small by international standards. Eleven banks are engaged exclusively in offshore activities and the remaining eight combine a mixture of offshore and onshore activities (mixed activity banks).

66. The combined balance sheet total for the 19 banks is £5.2 billion of which £1.9 billion relates to the offshore banks and £3.3 billion to the mixed activity banks.

67. The off-balance sheet activities of offshore banks amount to £25.7 million and £23.5 million for mixed activity banks. In addition, the offshore banks have funds under management of £5.1 billion while the total for mixed activity banks is £0.8 billion. Approximately 75 percent of total banking business originates offshore.

68. The EU Second Banking Coordination Directive established the Single European Passport for banks authorized with the EU. Since Gibraltar is part of the EU, the Directive was transposed with the jurisdiction under the Banking Ordinance 1992. Branches of authorized EU banks may set up in Gibraltar without the need for further authorization procedures by the FSC. Similarly Gibraltar-incorporated banks may also branch out into EEA member countries without further authorization from those states. In only 1999, the UK

authorities confirmed that they were satisfied with the banking supervision processes in Gibraltar and that Gibraltar-licensed Banks could passport banking services into member countries.

69. Ten banks are incorporated in Gibraltar, seven are branches of EEA banks and two are branches of non-EEA banks (Jersey and the Isle of Man). The Financial Services Commission (FSC) has primary supervisory responsibility for the 10 locally incorporated banks and the two non-EEA branches. The countries of origin for the EEA Branches (United Kingdom [4], Spain [1], France [1] and The Netherlands [1]) have primary responsibility for these branches.¹⁷ With the exception of one bank, which is minority owned by a bank and individuals, all banks are members of international banking groups.

70. Prior to 1992, two types of banking licenses were issued: Class, "A" that related to onshore activities and Class "B" (tax exempt) to offshore business. Since 1992, only one type of license has been issued. After being licensed, banks may select the nature of business they wish to engage in onshore, offshore or a combination of both. Market limitations and an accommodating tax structure largely drive this choice for banks engaged in the provision of banking services. A recent modification of the tax laws permit banks to elect to provide a mixture of offshore and domestic services with each activity taxed independently. No one bank deals exclusively onshore.

71. Bank operations are straightforward for both offshore and onshore banks. Most of the banks are used by their parents for deposit raising activities. For instance, of total assets £5.2 billion, £3.9 billion is placed with other banks, all outside Gibraltar, mainly with group banks. Total loans and advances amount to £1.2 billion with approximately 63 percent in the form of back-to-back loans.¹⁸ Total non-bank deposits amount to £2.5 billion and total bank deposits to £1.7 billion, again mainly from group sources. Banks in Gibraltar do not place or take deposits with or from one another. Total off-balance sheet operations amount to £49.2 million, all of which relate to traditional banking activities, for example guarantees and letters of credit. None of the banks engages in activities related to derivatives or securitization.

¹⁷ Under the EU Second Banking Coordination Directive, 1992 the country of origin (i.e., "home country supervisor") supervises all prudential aspects of its EEA banks' branches except for liquidity. Thus, the FSC is confined to monitoring the liquidity of these branches. For non-EEA branches, the FSC supervises all aspects except for capital and large exposures that are the preserve of the home country supervisors as branches are not required to have capital. The FSC is responsible for supervising all aspects of locally incorporated banks.

¹⁸ Back-to-Back loans are commonly used to facilitate cross-border lending. These loans are secured by funds in one jurisdiction, with the loan itself made in another jurisdiction secured by a formal pledge of the deposit/portfolio.

72. Thirteen banks maintain a book of assets under management amounting to £5.9 billion of which £4 billion are on a non-discretionary basis and £1.9 billion on a discretionary basis. These assets are managed in Gibraltar with advice from parent group companies.

73. The offshore customer base is primarily comprised of North European nationals who have settled in Spain and to a lesser extent Portugal. This base, particularly U.K. nationals, is attracted to Gibraltar because of its English tradition and familiar products and services. A number of banks have developed specialty mortgage services that target acquisition of residential real estate in Spain and Portugal.

74. The primary legislation covering the regulation and supervision of the banking industry is contained in the Banking Ordinance 1992. Under this ordinance, responsibility lies with the Commissioner of Banking who is also the Commissioner of the FSC.

75. The Banking Supervision Section is comprised of the Commissioner and two staff members: the Banking Supervisor and a Banking Analyst. These three supervisors have access to an IT expert and six general office support staff on an as needed basis.

76. The Banking Supervision Section supervises all licensed deposit-taking institutions in Gibraltar. As part of the European Union, Gibraltar is obliged to and has transposed all relevant EU supervisory legislation. In addition, Gibraltar is legally obliged to match U.K. standards of banking supervision.

77. Supervision embraces authorization, ongoing supervision and policy development. There is no difference in the supervision of domestic and offshore banks.

78. On the policy side, the Commission has produced a number of publications, which include a Handbook of Banking Supervision, Banking Guidance Notes and Banking Newsletters. It has also produced a guidance paper on the application of anti-money laundering legislation. It recently circulated a discussion paper among the industry proposing changes to the legislation and guidance paper. It also holds seminars on money laundering for the industry. All the publications mentioned above are available to the public.

79. The Handbook covers, inter alia, authorization procedures and details of the implementation of the various EU banking directives. The guidance notes cover such topics as: connected lending, provision of cross-border services and outsourcing. A draft guidance note on the development of a risk-based approach to banking supervision and one relating to provisioning policy are currently being finalized. Newsletters, 11 of which have been produced to date, deal with various aspects of banking supervision.

80. In addition to the above publications, the FSC has prepared a banking procedures manual for internal use. It covers such topics as objectives of supervision, application procedures for licenses, ongoing supervisory procedures and reporting requirements.

81. Authorization procedures follow best international practices. They include detailed discussions with the applicant, the submission of application forms from the prospective

bank, its shareholders, directors and managers. The requirements also include a comprehensive business plan. Fit and proper criteria are applied to shareholders, directors and managers¹⁹ as are requirements relating to experience and expertise, head office presence, minimum capital and four-eyes principles.

82. Ongoing supervisory requirements include the analysis of detailed quarterly returns, regular meetings with banks (prudential meetings), tripartite meetings attended by the FSC, the bank under review and its external auditor. The FSC also uses reporting accountants.

The quarterly returns include:

- a balance sheet incorporating off-balance sheet items,
- a profit and loss statement,
- the calculation of capital adequacy ratios,
- a large exposure listing,
- a liquidity maturity schedule,
- a lending book analysis (sectoral, regional and connected lending),
- a listing of the ten largest depositors and,
- details related to market risks.

83. Prudential meetings are held on bank premises twice a year for all banks incorporated in Gibraltar and for branches of non-EEA banks. Prudential meetings are held once a year for EEA banks. Among subjects discussed at these meetings are: matters outstanding, management and organization, money laundering controls, internal audit reviews, performance/ profitability, capital, liquidity and asset quality/arrears provisions.

84. The tripartite meetings are held following receipt of the external auditor's report. Items discussed would include any weaknesses uncovered by the auditor.

¹⁹ Every prospective controller or one already named is required to be a fit and proper person. In this regard, the Commissioner will consider an individual's probity, competence, and soundness of judgment for fulfilling the responsibilities of that position, the diligence with which that individual is filling or likely to fulfill those responsibilities and whether the interests of depositors or potential depositors are, or are likely to be, threatened in any way by his/her holding of that position.

85. The FSC requires an annual report from the reporting accountant for the twelve banks for which it has primary supervisory responsibility. Each year the reporting accountant will examine in some detail an aspect of the bank's activities that is determined by the FSC. Points covered by the reporting accountant have included:

- high level controls;
- credit risk;
- money laundering;
- information technology;
- private banking; and
- investment business.

86. The FSC does not carry out onsite inspections. Instead, it relies on the above procedures that are based on UK practices. However, the FSC is moving to a risk-based approach to supervision (in line with UK developments) that will involve onsite inspections.

87. The FSC is supported by a well-developed IT system. The system provides a wide range of timely management information including a database of all relevant details of the bank's activities. It contains statistical data from returns from 1990. It also allows for in-depth peer group analysis, trends and exception reports. An important additional advantage to the use of this system is that a recently hired analyst can input the data thus affording him an opportunity to become even more knowledgeable of the banks he is responsible for.

88. The following points are also relevant in understanding Gibraltar's banking system:

- a depositor's protection scheme, based on the relevant EU Directive, was put in place in 1999;
- the FSC is the "Authority" responsible for overseeing the banks' (including the seven EEA branches) adherence to anti-money laundering legislation;
- none of the banks licensed in Gibraltar has an overseas presence;
- the FSC's approach to information exchange is based on EU legislation;
- three overseas banks from Morocco, Jersey, Isle of Man have representative offices in Gibraltar.

B. Assessment

89. In general, there is a high level of compliance with the Basel Core Principles for Effective Supervision of Banking in Gibraltar. Gibraltar is compliant with 18 of the principles and largely compliant with the seven other principles. There are no instances of being materially non-compliant, or of non-compliance. This assessment is summarized in the attached Table 3.

90. The assessors noted that the nature of business undertaken is relatively limited and straightforward.

91. In general, the FSC has the necessary legislative base to undertake effective supervision and carries out its functions in a professional and dedicated manner.

92. It was evident that the FSC carried out its duties diligently and had an intimate knowledge of the banks under its supervision. In some instances, its approach appeared informal but this is a characteristic of small jurisdictions where the regulators and principals of regulated entities are well known to each other. During the course of the review, the assessors visited a number of banks and noted that there was general acknowledgement of the FSC's professional approach.

Areas where improvements would be beneficial

Independence and Resources (BCP 1.2)

93. Gibraltar is largely compliant with this principle. The supervisory regime is enhanced by a highly motivated and experienced staff. The Commissioner has 15 years and the Supervisor 10 years of supervisory experience and the analyst less than one. The number of staff is inadequate to carry out its day-to-day performance demands and will be even more so following the introduction of onsite inspections and the adoption, as we recommend, of a more structured approach to assessing banks' compliance with anti-money laundering procedures. Currently, the department has one experienced banking analyst and a relatively recent recruit.

Recommendation

It is recommended that at least one additional analyst be hired, preferably with direct onsite inspection experience.

Legal Protection (BCP 1.5)

94. Gibraltar is largely compliant with this principle. There is no statutory provision protecting the FSC's staff against civil suits and indemnifying them against the costs associated with such suits.

Recommendation

It is recommended that relevant legislation be amended to provide for such protection.

Loan Principles (BCP 7)

95. Gibraltar is largely compliant with this principle. There is no explicit requirement for the FSC to verify periodically that prudential credit granting and investment criteria, policies, practices and procedures are approved, implemented, and reviewed by bank management and boards of directors.

Recommendation

It is recommended that the draft guidance notes addressing this issue be adopted as a matter of urgency.

Loan Classification (BCP 8)

96. Gibraltar is largely compliant with this principle. The FSC does not require loans to be classified when payments are contractually a minimum number of days in arrears.

Recommendation

It is recommended that the FSC require banks to introduce a loan classification regime that would reflect best international practices.

Country Risk (BCP 11)

97. Gibraltar is largely compliant with this principle. Exposures are not identified on an individual country basis, nor has the FSC decided on an appropriate minimum provisioning policy.

Recommendation

It is recommended that exposures be classified and monitored on an individual country basis and that appropriate minimum provisioning policy be introduced.

Internal Controls (BCP 14)

98. Gibraltar is largely compliant with this principle. There is no formal requirement for banks to appoint non-executive directors to their boards or for the internal audit function to report to an audit committee.

Recommendation

It is recommended that banks be required to appoint non-executive directors and to establish audit committees to which the internal audit function would report.

Money Laundering (BCP 15)

99. Gibraltar is largely compliant with this principle. The FSC is responsible for monitoring compliance by all banks (including the 7 EEA branches) with anti-money laundering legislation. Each year the internal audit function of each bank carries out a review of anti-money laundering procedures. The FSC receives a report of these reviews and will raise any relevant findings with the bank in question. The FSC also raises compliance issues with each bank during prudential visits. In addition, for the 12 banks for which it has primary supervisory responsibility, the FSC employs reporting accountants to assess such compliance. However, the last time most of these banks were assessed was 1997 and only two were assessed in the last two years.

Recommendation

It is recommended that the FSC adopt a more structured approach to overseeing compliance with anti-money laundering procedures. In particular, the mission recommends that regular anti-money laundering assessments form a regular part of the proposed introduction of the onsite inspection regime.

Corrective Action (BCP 22)

100. Gibraltar is largely compliant with this principle. The FSC does not have the legal authority to apply civil money penalties to a bank, the board of directors or management.

Recommendation

It is recommended that appropriate legislation be enacted to give the FSC authority to directly apply such penalties.

Table 3: Compliance with Basel Core Principles

Core Principle (CP)	Principle	Degree of Compliance				Comments including improvements underway
		Compliant	Largely Compliant	Materially Non-Compliant	Non-Compliant	Not Applicable
1.1	Clear supervisory responsibilities	X				
1.2	Independence and resource		X			Supervisory resources are inadequate. No statutory provision for disclosure of reasons for removal of Commissioner.
1.3	Legal framework	X				
1.4	Supervisory powers	X				
1.5	Legal protection		X			There is no statutory provision protecting the Commission or its staff against civil suits and indemnifying them against the costs associated with such suits.
1.6	Information sharing	X				
2	Permissible activities	X				
3	Licensing	X				
4	Transfer of ownership	X				
5	Acquisitions and investments	X				
6	Capital requirements	X				
7	Loan principles		X			There is no explicit requirement for the Commission to periodically verify that prudential credit granting and investment criteria policies, practices and procedures are approved, implemented and periodically reviewed by bank management and boards of directors. (This is currently being addressed by way of a draft Guidance Note).
8	Loan classification		X			The FSC does not follow the Basel Core Principles recommendations regarding the classification of loans 90 days past due as non-performing.
9	Large exposures	X				
10	Connected lending	X				Exposures are not identified on an individual country basis nor has the FSC decided on an appropriate minimum provisioning policy.
11	Country risk		X			Exposures, however, are closely monitored on a regional basis and the level of lending outside of Western Europe is negligible.
12	Market risk	X				
13	Other material risks	X				
14	Internal controls		X			Currently there is no formal requirement for the appointment of non-executive directors, nor for the internal audit function to report to an audit committee.

Core Principle (CP)	Principle	Degree of Compliance					Comments including improvements underway
		Compliant	Largely Compliant	Materially Non-Compliant	Non-Compliant	Not Applicable	
15	Money laundering		X				The FSC needs to adopt a more structured approach to assessing compliance with anti-money laundering procedures, particularly in the context of the proposed introduction of an onsite inspection regime.
16	Onsite-offsite supervision	X					
17	Understanding banks' operations	X					As permitted under the Core Principles the FSC uses external bodies to undertake onsite inspections. The FSC has initiated a move towards a risk-based supervisory regime, which will incorporate onsite inspections.
18	Consolidated reporting	X					
19	Independent validation	X					
20	Consolidated supervision	X					
21	Accounting and disclosure	X					The FSC does not have a legal basis to apply penalties to a bank, board of directors or management.
22	Corrective action		X				
23	Global supervision	X					
24	Cooperation with foreign supervisors	X					
25	Foreign banks' branches	X					

V. ASSESSMENT OF INSURANCE STANDARDS

A. Introduction

101. At the end of April 2001, 18 companies were licensed under the Insurance Companies Ordinance 1987 to carry on insurance business in Gibraltar. Of these 18 insurers, two are catering to the domestic market while the remaining 16 are writing risks situated in foreign jurisdictions, either directly or by way of reinsurance. There are no "brass plate" insurers in Gibraltar.

102. Only one of the 18, by use of the EU cross border rules, carries on insurance business by establishment in an EEA country (the United Kingdom) but nine are entitled to provide services in several EEA countries. The most significant of these can provide services in 18 of these countries. Gibraltar has implemented all but one (the Insurance Groups Directive) of the EU Directives relating to insurance supervision.

103. Ten of the 18 insurers are captives; these are generally insurance companies that primarily cover the risks of the parent company or of affiliated companies.

104. The captives are mostly managed by insurance managers who are themselves licensed under the Financial Services Ordinance 1989. There are seven such licensed insurance managers although two of them have not yet taken on any insurers under management.

105. The latest available figures show that gross premium income of the licensed insurers is approximately £70 million and that the total assets are about £210 million. Of the gross premium income, 55 percent has its origins in the U.K., 21 percent in Europe, only 4 percent in Gibraltar, and 20 percent in the rest of the world.

106. Gibraltar, as part of the EU, has EU resident insurers writing Gibraltar based risks either through established branches or on a services basis. The branches, presently all consisting of agency representations, are licensed and supervised by the relevant EEA country. A number of other overseas insurers also provide services in Gibraltar through intermediaries.

107. There are 25 insurance intermediaries serving Gibraltar residents although some of these provide services to residents in foreign jurisdictions. Of the 25, 16 sell only life products, the rest both life and non-life products. There are only three insurance brokers, all the remainder are agents. These insurance intermediaries are supervised under the Financial Services Ordinance 1989, and are also able to place insurance business with insurers from foreign jurisdictions.

108. The legislation follows that mandated by the EU Directives, and the style of supervision is very much that of the United Kingdom. In cases where insurers operate through branches in other EU member countries there is a system of home and host insurance supervision, with the home supervisor licensing and supervising the insurer, including the

branch, for prudential purposes. The host supervisor will concern himself with market conduct aspects of supervision.

109. The supervisory process in Gibraltar revolves around the licensing and continuing monitoring of the insurer. The main aspects of the licensing procedures are fit and proper criteria (i.e., appropriate knowledge, skills and integrity) tests to determine the quality of shareholders, directors and other notifiable persons and ensuring that the business proposals are feasible, bearing in mind the insurance and reinsurance program. Particular attention is given to the retentions of the insurer and of the protection provided by the reinsurance program. The continuing monitoring involves the offsite inspection of quarterly management financials and the annual inspection of the independently audited annual financial statements. In addition, there is regular contact with the insurance managers, along with ad hoc meetings with insurers to discuss any material changes to the applications and the latest submitted business plans.

B. Assessment

The standards and practices of insurance supervision were reviewed in comparison with the Insurance Core Principles and Insurance Core Principles Methodology promulgated by the International Association of Insurance Supervisors (IAIS). The mission's overall impression is that insurance is supervised to a good standard by experienced professionals.

110. We consider that Gibraltar is observant of 13 of the 17 Core Principles of Supervision, and largely observant of three others, and materially non-observant of one principle. The latter relates to onsite visits, and the FSC is considering what needs to be done to fully observe this principle. The full assessment is summarized in the attached table 4.

Areas where improvements would be beneficial

111. The following paragraphs contain our main recommendations, mainly applicable to those principles of which Gibraltar was either largely or materially non-observant.

Organization (IAIS 1)

112. Gibraltar is observant of this principle. However, the current insurance supervisor, who is a very experienced plans to retire at the end of September 2002. It is essential that succession planning should be discussed and the policy implemented at an early stage. It is fortunate that the current assistant insurance supervisor is able and experienced, an invaluable part of the team, but he has other duties as the Financial Controller for the Commission, although these duties do not occupy a large part of his time. His position within the insurance division also requires succession planning. The steadily growing numbers of licensed insurers in Gibraltar, the diversity of knowledge needed; the need for comprehensive onsite inspections; the demands from EU, the United Kingdom., and international initiatives are important factors relevant to the adequacy of resources.

Recommendation

If Gibraltar is to continue to support regulatory progress it must plan its resources accordingly. Taking all of the above into account we recommend that the Commission consider the issue of succession planning as much in advance as possible. This should be done in ways that minimize gaps in expertise and take into account the growth of the insurance sector in Gibraltar, the need for more onsite supervision and the continuing demands made by international initiatives. Our assessment is that there will be a need for increased staff in the future, possibly at the senior analyst level plus another person to assist part time with onsite visits.

Licensing (IAIS 2)

113. Gibraltar is observant of the licensing principle. The Commissioner is prohibited from issuing a license to an applicant if it appears that any director, controller, manager or main agent of the applicant is not a fit and proper person to hold the position under consideration (Section 24A). In addition he/she may not issue a license to an applicant if it appears that the criteria of sound and prudent management are not fulfilled or will not be fulfilled with respect to the applicant. The criteria of sound and prudent management, which cover such matters as integrity and skill, number of persons who direct and manage the insurer, and the conduct of business, are set out in schedule 15 of the Ordinance.

114. Gibraltar is fully aware of the risks involved for jurisdictions that seek to attract non-domestic insurance business. These include the probable involvement of foreign residents in some part in the procurement process, the attendant difficulties with due diligence, and, possibly a large reputational risk for Gibraltar, should the company fail. The insurance supervisory team has named several cases where due diligence has successfully deterred unsuitable persons from participating in the Gibraltar insurance sector. The team makes great efforts to check the bona fides of potential entries to the market, but this is sometimes made difficult by poor response rates internationally. Because it is one of the smallest jurisdictions within the EEA, there could be a perception by the international insurance sector that smaller operations, with participants that are not already in the sector, or with participants with a less than excellent reputation would be welcome establish themselves in Gibraltar. Gibraltar has been at pains to make it perfectly clear that this is not the case, and should continue to do so.

115. It is often the case that persons can give acceptable answers to all of the fitness and propriety questions asked and can pass police and other checks but the insurance supervisor receives a verbal opinion from another foreign supervisor that the individual is "under investigation", "being watched" or other similar wording. This falls short of absolute evidence that the individuals are not fit and proper, and it is sometimes difficult for the Commissioner to find reason to refuse the application. The Ordinance contains sufficient grounds for refusing a license if the Commissioner has even a small doubt of the suitability of the applicant and these grounds should be used if that doubt exists.

The Commissioner has issued a very comprehensive note on the identification of notifiable persons (which includes fitness checks) as part of the insurance procedures manual (insurance internal guideline No. 4).

Recommendations

The system is already very detailed but we recommend that it could be extended even further. It is not difficult to overlook one of the checks that may hold a vital clue to fitness and propriety. Therefore, we suggest a fitness checklist, containing all possible checks, instituted for all notifiable persons and that if there are any slight questions arise against them, the application should be refused on grounds that do not infringe upon human rights regulations. Currently, there is no application checklist in use; we recommended that the fitness check list be incorporated within such a list when it is developed.

When there is a review of the Insurance Ordinance we recommend that the reasons for refusal or revocation of licenses should be expanded so that the Commissioner has the widest choice of reasons, including the person's participation in unsound transactions. The policy should, in addition, be clearly stated to all involved in the insurance sector so that they are aware of the higher standards that apply to Gibraltar insurers than to many other jurisdictions. The insurance sector should play an integral part in this aspect of the work of the Commission.

The Commission should introduce a more structured approach to determining exposure on the insurance business underwritten. Such a method would include the use of exposure spreadsheets. This would apply mainly at application stage but could be used to monitor any proposed material changes during the year. It is important that the insurance managers and any prospective applicants have the prior knowledge of and are made aware of the methods used by the insurance supervisor.

Corporate Governance (IAIS 4)

116. Gibraltar is largely observant of this principle. There are no individual sections under the legislation dealing specifically with corporate governance. The essential criteria, therefore, cannot be regarded as being met directly. In 1998 the Commission issued a newsletter setting out the principles and practices of corporate governance. In meetings and in visits to the insurers, the insurance supervisory team forms a view on whether the principles of good corporate governance are being observed against the criteria set out in the 1998 Newsletter but there are no standard questions used.

Recommendation

We recommend a review of all licensed companies and the adoption of the corporate governance arrangements set down in the essential and additional criteria brought out by the IAIS in principle number 6. In the case of managed captives the criteria should

be slightly adapted to take account of the role that the insurance manager plays. We recommend that the Commission be given direct powers to specifically deal with corporate governance issues.

Capital adequacy and solvency (IAIS 8)

117. Gibraltar is observant of this principle of capital adequacy and solvency since it follows the EU Solvency Directive. However, it, like the United Kingdom has not yet implemented the new Insurance Groups Directive that will help counter the problems of double/multiple/gearing of capital. Recommendation

Recommendation

We recommend that Gibraltar should implement this directive as soon as possible.

Market Conduct (IAIS 11)

118. Gibraltar is largely observant of this principle. Long-term life assurance contracts with an investment element are investments for the purposes of the Financial Services Ordinance 1989 ("the Ordinance", for the purposes of this section only). Intermediaries selling such investment products must be licensed under the Ordinance. In addition, insurance broking or acting as an insurance agent with regard to other forms of life assurance or general insurance is a controlled activity for the purposes of the Ordinance. It follows that all insurance intermediaries must be licensed under the Ordinance 1989 and that all the requirements of the Ordinance and related regulations and guidelines apply to insurance intermediaries, as they do to any other entities licensed under the Ordinance. Taken together, the legal obligations imposed on licensed intermediaries cover the areas included in principle 11 (market conduct). The detailed requirements of principle 11 are closely matched by the statement of principles set out in Part II of the Financial Services (Conduct of Business) Regulations 1991 ("CoB").

119. For administrative convenience, the investment services supervisor is responsible for supervising the activities of general business insurance intermediaries. However, the definition of controlled activities in the Financial Services Ordinance, 1989 is unclear. Under the heading "insurance broking" it is defined, inter alia, as "Carrying on any insurance business, which takes or uses any style, title or description, which consists of or includes the expression insurance broker or insurance agent or inviting for profit or reward another person to make an offer or proposal, or to take any other step, with a view to entering into a contract of insurance with an insurer." This implies that sales by insurers direct to the public are not covered by the market conduct rules of the investment services supervisor.

120. There are certain market conduct rules (for example commission disclosure) that are not mandated in Gibraltar, the investment services supervisor taking the view that, because of the very small domestic market, any such measures would deter insurers from underwriting

Gibraltar risks and thus restrict consumer choice. We are not able to take any view on these areas, but would suggest a review of the relevant rules.

121. The insurance supervisor (because intermediaries are monitored by his colleague) does not take such a keen interest in market conduct issues. However, there are disclosure requirements in the Directives and there are guidance notes issued under the Insurance Companies Ordinance.

122. There are disadvantages of splitting the supervision of products between two sets of legislation and overviewed by two different supervisors. In small jurisdictions, invariably, the insurance expertise lies with the insurance supervisor. The counter argument is that taking away insurance market conduct issues from investment supervision could result in different methods of supervision of, for example, unit trusts and unit-linked bonds, which are virtually the same product. It would also mean that intermediaries selling both investment products and insurance products would be licensed under two different sets of legislation, unless a single financial services law is produced. These split roles do not seem to be the ideal solution and we suggest that, at some time in the future, this aspect of supervision should be reviewed.

123. Now that passporting has proven to be effective and is about to be utilized by more Gibraltar insurers, we believe that the insurance supervisor should take a greater interest in the products on offer and in the product literature so that he can be sure that they broadly meet the expectations of any prospective policyholder, whether resident in Gibraltar or elsewhere. Market conduct should be the province of the host supervisor, but Gibraltar needs to be extra careful that its reputation cannot be damaged.

124. Onsite visits to intermediaries have been deferred, as the Commission's staff members have had to spend considerable amounts of time on EU and U.K. matters. Other similar jurisdictions have found that onsite inspections have unearthed a relatively significant amount of irregularities, especially in the areas of money laundering and client recording (fact finds). The former is an area where traditionally the industry (both life and non-life) has not realized just how vigilant they have to be. In order to keep Gibraltar's reputation intact the Commission should commence a structured program of onsite visits using comprehensive checklists.

125. There is no direct supervision of insurance sales persons and there are no direct powers to stop an individual, who may not be fit and proper, selling insurance products. These deficiencies should be addressed.

126. Gibraltar has no policy holder protection scheme. Most jurisdictions have in place a system of levies, either prospective or retrospective, that are contributed by industry. The problem is that with only two companies in Gibraltar licensed to write life business, if one were to become financially impaired, the other would be unable to afford to pay the huge amount to the compensation fund. An alternative is to keep assets, representing policyholder liabilities, with an independent trustee/custodian. Our view is that none of these methods is as

yet suitable for Gibraltar but that the issues should be regularly revisited as the market changes. However, we do feel that the relevant supervisor should mandate that appropriate warning notices should be present on all life policy literature. In accordance with the Conduct of Business Regulations such as warning needs to be in any advertisement issued by an unlicensed non-EEA insurer.

127. There appears to have been few miss-selling problems of the type, which occurred in the U.K., regarding endowment policies. This is probably due in part to large advantages in the purchase of such policies because of taxation allowance, which were abolished in the U.K.

128. A lack of resources may be holding back proactive work (including onsite visits and money laundering checks) of the investment services supervisor.

129. Handling complaints in the best interests of policyholders could involve a conflict with prudential supervision. This conflict would not be there if complaints were resolved by the establishment of an alternative dispute mechanism.

Recommendation

We recommend that there be a full review of market conduct issues, taking into account the above comments (especially those relating to onsite inspections); a review of qualification requirements; a review for possible omissions in the conduct of business regulations; the collation of more reliable statistics and a fuller consideration of overseas policyholders. Finally, Gibraltar should seek to employ a financial services ombudsman, or someone similar, in order that disputes between licensee and consumers can be readily resolved.

Onsite Inspection (IAIS 13)

130. Gibraltar is materially non-observant of this principle. Supervisory visits to companies are carried out to inform the supervisory team of each company's activities, organization, approach to record keeping, customer care, and other matters that are not readily obvious from the financial information submitted. These 'supervisory visits' stop short of being 'onsite inspections' in the sense that there is no detailed examination of documents

131. Full onsite inspections represent an invaluable asset to the supervisor in the prudential supervision of insurers and insurance intermediaries. An additional component to the inspections should be that of money laundering avoidance checks, which is an area not proactively monitored elsewhere or by other authorities. The onsite inspections are also a check on the other IAIS Core Principles, and are especially valuable in the areas of corporate governance and internal controls.

Recommendation

We recommend that a structured program of onsite visits be instituted as soon as possible using a detailed check list (including a money laundering module) with the objective of an inspection every three years, or more frequently, allowing appropriate feedback from the insurer or insurance intermediary.

Sanctions (LAIS 14)

132. Gibraltar is observant of this principle. The Ordinance, Sections 62 to 70 and 98 to 109 give the Commissioner a wide range of powers that enables him to take remedial action. These range from the power to fine companies when their financial statements are submitted late, through the power to withdraw a company's license in the event that it becomes insolvent or is not being administered in a sound and prudent manner.

133. There are, however, certain powers that are stated explicitly in the IAIS's principles that are not reflected directly in the Gibraltar legislation. The FSC believes that it can achieve the same results by using the ultimate power of withdrawal of the license as a threat. The mission believes that it would be beneficial to the FSC and the industry, and less open to legal challenge if the specific powers were to be included within the legislation.

Recommendation

We recommend that there be a review of the powers available to the Commissioner and that legislation be amended to include the specific powers outlined in Chapter III C above.

Coordination, and Cooperation (LAIS 16)

134. Gibraltar is largely observant of this principle of coordination and cooperation. The Financial Services Commission also supervises Banking and Investment Services activities. Information relating to the supervision of these entities is also available and is shared between the relevant supervisors in the Commission. Formal memoranda of understanding (MOU) have not been concluded in any significant numbers with supervisors in other jurisdictions but that the lack of MOU's has not affected Gibraltar's ability to share information of mutual interest.

135. The Insurance Commissioner is not routinely informed about insurance fraud or money laundering within the insurance sector. The Insurance Supervisor does not have any statistics about the number or types of disclosures made by the insurance sector. Some of the disclosures could reveal matters of potential concern for the Insurance Supervisor.

Recommendation

It is recommended that regular meetings be held with the Financial Intelligence Unit (FIU) in order to exchange information about money laundering within the insurance sector.

Table 4: Observance of International Association of Insurance Supervisors (IAIS) Core Principles

Core Principle (CP)	Principle	Degree of Observance					Comments including improvements under way
		Observant (FO)	Largely Observant (LO)	Materially Non-Observant (MNO)	Non-Observant (NO)	Not Applicable (NA)	
	Organization of Insurance Supervisor						
1	Organization	X					
	Licensing and Changes in Control						
2	Licensing	X					
	Changes in control						
3	Changes in control	X					
	Corporate Governance						
4	Corporate governance		X				A review of all licensees is needed with eventual law changes to give the Commissioner specific powers.
	Internal Controls						
5	Internal controls	X					
	Prudential Rules						
6	Assets	X					
7	Liabilities	X					
8	Capital adequacy and solvency	X					Should implement EU Insurance Groups Directive as a matter of urgency
9	Derivatives and off-balance sheet items	X					
10	Reinsurance	X					
	Market Conduct						
11	Market conduct		X				Full review of market conduct issues required.
	Monitoring, Inspection, and Sanctions						
12	Financial reporting	X					
13	Onsite inspection			X			Structured, documented onsite inspections required.
14	Sanctions	X					Some sanctions currently indirect and a change to more specific language is recommended.
	Cross-Border Business Operations						
15	Cross-border business operations	X					
	Coordination, Cooperation, and Confidentiality						
16	Coordination and cooperation		X				Regular meetings should be held with the FIU in order to exchange information about money laundering within the insurance sector.
17	Confidentiality	X					

VI. ASSESSMENT OF INVESTMENT AND SECURITIES STANDARDS

A. Introduction

136. The investment services sector may be divided into two principal groups: those that serve the needs of the local community by providing collective investment schemes and insurance products with an investment value; and those that provide portfolio management and other investment services to institutions and high net worth individuals. About 22 insurance intermediaries are in the first group and about 28 securities firms are in the second group. Some of the latter have discretionary authority over their customers' accounts. In addition, there are two locally operated collective investment schemes and about 42 recognized collective investment schemes that are marketed locally but have been authorized and are operated from elsewhere, mainly in other EU jurisdictions. Finally, about seven banks provide investment services under authority of the banking laws. None of the securities firms deals as principal with its customers, none provides underwriting services, and there are no securities exchanges. Total assets under management at year-end 2000 were about £6.9 billion.

137. Investment services provided in or from within Gibraltar are subject to the requirements found in Financial Services Ordinance, 1989, and the Financial Services Ordinance, 1998 (FSO 89 and FSO 98). The Commissioner, Financial Services Commission (FSC), is responsible for carrying out the provisions of the statutes referred to above; this individual is assisted in relation to investment services by the investment services supervisor, and part of the time of an assistant supervisor, with additional staff support. Responsibilities of the Commissioner and staff include that of ensuring that the supervision of investment services complies with any of Gibraltar's obligations to comply with directives of the European Union; and to establish where EU law applies, supervisory standards that match those applied in the United Kingdom.

138. A securities firm that is formed under local law, or that maintains its headquarters in Gibraltar, must obtain specific authority from the FSC to provide investment services in or from Gibraltar. The regulator has established an application procedure that develops detailed information concerning the investment services to be provided, the financial resources that will support the proposed operation, and the background and experience of the principals that will control and manage the company.

139. Licensees must designate a compliance officer although, depending on the size of operations, that need not be a full-time position. The FSC is authorized to impose conditions upon the exercise of any authority granted to the licensee pursuant this procedure. The public is informed regarding the identity of licensees through the publication by the FSC of lists by category, in the agency's annual report and on its website, of persons that have been authorized to conduct the securities business in Gibraltar.

140. Providers of investment services in Gibraltar are subject to prudential regulation, capital adequacy requirements, disclosure requirements, conduct of business regulation

(including marketing restrictions) and reporting obligations. Persons seeking to establish, manage or promote a collective investment scheme within Gibraltar must obtain authority therefore under Part III of FSO 89; in addition, collective investment schemes organized and/or operated elsewhere must be recognized by the FSC prior to being marketed in Gibraltar. Schemes that satisfy the requirements of the UCITS directive have a right to be marketed in Gibraltar.

141. While the law establishes the duties of directors, the FSC has issued a newsletter that elaborates upon and develops these standards. Under Section 10 of FSO 98, the FSC monitors acquisitions of controlling interests and changes in control of securities firms regulated under that Ordinance; and where it objects, it may seek to bar the person from voting the shares to be acquired, subject to procedural requirements. The FSC has publicly stated that it is committed to the full range of international supervisory standards; and that it will permit no "brass plate" operations. Further, the FSC is required by law to consider only applications to carry on the investment business from or within Gibraltar where the "mind and management" of the enterprise for which approval is sought are located within the jurisdiction; and that the "four eyes" principle, under which at least two individuals must effectively direct the enterprise and participate in major decisions, will be applied.

142. The FSC has also taken steps to close down the operations and freeze the assets of unlicensed securities firms that were registered in Gibraltar but sold their products and conducted their operations entirely outside the jurisdiction, thereby protecting Gibraltar against reputational risk. Carrying these stated intentions into effect appears likely to limit the opportunities for misuse of an investment firm license in this jurisdiction.

143. Section 50 of FSO 89 provides for the receipt in confidence of information regarding individuals and establishes a framework for such information to be passed on to other authorities when the FSC believes that is necessary to enable the agency to carry on its statutory functions, or in the interests of the prevention or detection of crime, or in discharge of international commitments, or (in the absence of treaty obligation) to assist authorities in other countries in the discharge of regulatory responsibilities similar to those exercised by the FSC. While the number of formal arrangements with other regulators is limited by Gibraltar's political status, the FSC indicates that lack of explicit undertakings has not inhibited exchanges of information and that it has, in fact, provided and received confidential information from securities regulators in other jurisdictions.

144. Gibraltar is moving to bring itself into compliance with the European Union's Investor Compensation Schemes Directive (ICD); in May 2001 the Government of Gibraltar issued a Consultation Paper that outlines a proposal pursuant to which a safety net will be erected for small investors that provides a minimum level of protection in the event that a securities firm is unable to meet its obligations. Under the proposal, investment firms for which Gibraltar is the home state will be required to join the Gibraltar Investor Compensation Scheme (GICS) that will administer the Gibraltar Investor Compensation Fund. The Commissioner of FSC will serve as Chairman of GICS.

145. In the event that an investment firm is unable to meet its obligations to its clients, GICS would make a levy on all member firms in an amount sufficient to provide coverage for 90 percent of the value of consumer claims up to a maximum of £13,000 per investor. Alternatively, the proposal states that consideration will be given to the possibility of obtaining insurance in the amount required to provide the necessary cover. While the ICD permits the use of levies, that method of funding a contingent liability of this nature carries the possibility that the failure of one firm could trigger systemic difficulties in the sector within Gibraltar.

B. Assessment

146. In general, there is a high level of compliance with the IOSCO Objectives and Principles of Securities Regulation. Gibraltar is compliant with 19 of the principles, largely compliant with three and eight are not applicable. Although some powers are indirect, the FSC has the necessary legislative base to undertake effective supervision of the investment and securities industry. The mission has made some suggestions about amending the law to make some powers more explicit. The full assessment is summarized in Table 5.

Areas where improvements would be beneficial

Clear Responsibilities (IOSCO Principle no. 1)

147. Gibraltar is compliant with this principle. IOSCO identifies certain core objectives of the principle, including (i) that markets are fair, efficient and transparent and (ii) that systemic risk is reduced. These may fairly be considered to be subsumed within the language of the Gibraltar statute and FSC staff appears to have these objectives in mind as they carry out their responsibilities.

148. However, for greater certainty, Gibraltar may want to consider making explicit the core objectives as stated by IOSCO. That could have the effect of enhancing the institutional focus of the FSC, and may be useful, should a reviewing court be called upon to resolve an ambiguity to bring about a construction of the statutes governing the investment industry that is favorable to the core objectives of securities regulation.

Recommendation

The responsibilities of the FSC as stated in the law should be amended to specifically include: (i) protect investors, (ii) ensure that markets are fair, efficient and transparent, and (iii) reduce systemic risk.

Adequate Resources (IOSCO Principle no. 3)

149. Gibraltar is largely compliant with this principle. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

150. While the FSC thus exercises significant supervision over securities firms, it does not conduct onsite inspections using its own personnel with the exception that inspections of new licensees are made immediately after they have opened for business. The FSC believes that the formal regulatory reports that it receives from the institutions, as well as information received from third parties in this small community, keep it well informed regarding investment firms; and that a risk-based focus to its efforts suggests that its limited resources are better deployed otherwise.

151. While onsite inspections do require the dedication of resources, they can also yield significant benefits. Experience demonstrates that knowledge within an industry that onsite inspections are made by the regulator, even if they are not made frequently in the case of institutions that are well run, has a beneficial effect on the compliance record of industry participants. Onsite inspections also serve the useful function of increasing the regulator's understanding of the business and clientele of the industry that is being regulated. These benefits are difficult, if not impossible, to achieve through means other than onsite inspections.

152. Therefore, while the constraints imposed by limited resources in this jurisdiction might require initial reliance on external auditors for this purpose, we recommend that the FSC institute a formal program of onsite inspections of securities firms on a regular cycle; further, in connection with new licensees, an inspection about six months after business commences (the exact timing depending on the circumstances of each case) is useful to monitor compliance with the business plans and projections originally submitted.

Recommendation

The FSC should add resources to give it the capacity to perform in a timely manner a range of supervisory functions, including onsite inspections, offsite monitoring and the preparation of procedural and examination manuals.

Self-Regulatory Organizations (IOSCO Principles nos. 6, 7)

153. These principles are currently not applicable in Gibraltar. The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets.

Recommendation

SROs can be a valuable complement to regulatory oversight in achieving the objectives of securities regulation. The FSC should take into account Gibraltar's unique circumstances, the manner in which SROs could augment its own efforts in securities regulation.

Compliance (IOSCO Principle no. 10)

154. Gibraltar is largely compliant with this principle. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

155. The FSC does not use procedural manuals in connection with its supervision of investment firms, and since it does not ordinarily conduct onsite inspections, it does not use examination manuals either. The development and use of such manuals can promote institutional continuity; facilitate the integration of new personnel as the section grows or as staff members retire; and enhance consistency in the treatment of regulated institutions. Procedural and examination manuals, when made available to securities firms, can increase the level of compliance and the utilization of best practices by participants in this sector. In light of limited staff resources available for this purpose, consideration could be given by the FSC to outsourcing the actual preparation of manuals.

156. Criteria employed by the FSC in connection with the processing of applications as well as in various other matters, require the Commissioner to determine whether a prospective principal of an applicant meets the "fit and proper" criteria before holding the prospective position; to aid in making this determination, and to inform the public regarding the factors likely to be considered, the FSC has developed internal guidance that discusses this test in some detail (while the memorandum refers to itself as a "Newsletter," FSC staff states that it is not yet made available publicly). The law states that the requirement applicable to principals of a licensee to remain fit and proper in order to hold their positions is a continuing one, but the consequences of failure to meet that standard on an ongoing basis are not clear. If the guidance were public and specifically stated that there is a continuing requirement to meet the test and that failure to continue to meet the test disqualifies the individual from further service, the mission believes that the FSC's legal position would be strengthened when it took action to demand an end to the individual's service with the institution if so desired. The occurrence of events affecting on a person's ability to continue to meet the fit and proper test could be monitored through a requirement calling for the submission of updated financial and biographical information to be provided to the FSC on a periodic basis.

Recommendation

The FSC should use onsite inspections as well as procedural and examination manuals. The FSC, acting with the advice of counsel, should issue a guidance note setting forth the fit and proper criteria. In so doing, the FSC should ensure that the criteria are transparent, provide clear guidance to the public, place limits on the discretion available in administering this test; specifically asserts that the obligation of a licensee's directors and executive officers to remain fit and proper is a continuing one; and that failure to meet this test is grounds for removal of the person by the FSC.

Internal Organization and Operation of Market Intermediaries (IOSCO Principle no. 23)

157. Gibraltar is largely compliant with this principle. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters. Licensees are also required to keep compliance manuals and compliance records, and to report compliance breaches annually to the FSC. In order to ensure compliance, the FSC should have an independent review conducted of the licensee, either by the FSC or a third party on behalf of the FSC.

Recommendation

The FSC should use onsite inspection procedures to spot check compliance, even in the absence of suspected breaches.

Table 5: Compliance with International Organization of Securities Commission (IOSCO) Objectives and Principles

Core Principle (CP)	Principle	Degree of Compliance				Comments including improvements underway
		Compliant (FC)	Largely Compliant (LC)	Materially Non-compliant (MNC)	Non-compliant (NC)	Not applicable
	Regulator					
1	Clear responsibilities	X				Law should be amended to provide clearer statement of IOSCO core principles
2	Independence	X				Regulator operates independently of sectoral interests, is accountable to Commission and public
3	Power, resources and capacity		X			Powers adequate but limited resources reduce capacity. Staff has limited experience in securities regulation and supervision.
4	Clear and consistent regulatory process	X				
5	Staff with highest professional standards	X				
6	Self-Regulatory Organizations (SRO)					
7	Appropriate use of SRO					No SROs in Gib; FSC should consider possible use
8	Oversight of SRO and its observance of standards					X
9	Enforcement of Securities Regulation					X
10	Comprehensive inspection and surveillance powers	X				FSC has used investigatory and surveillance powers 15 times in last 2 years
11	Comprehensive enforcement powers	X				Enforcement powers should be enhanced regarding civil money penalties
12	Effective use of powers and compliance program		X			Lack of onsite inspections, lack of procedural and exam manuals
13	Cooperation and Regulation					
14	Information sharing with counterparts	X				
15	Information sharing mechanism	X				Law provides authority to share and despite international political considerations, effective sharing is done
16	Assistance to foreign regulators	X				
17	Issuers					International accounting and audit standards in place
18	Disclosure of financial results	X				
19	Fair and equitable treatment of holders of securities	X				
20	Accounting and auditing standards	X				
21	Collective Investment Schemes (CIS)					
22	Standards for eligibility and regulation	X				CIS must be authorized under statutory standards

Core Principle (CP)	Principle	Degree of Compliance					Comments including improvements underway
		Compliant (FC)	Largely Compliant (LC)	Materially Non-compliant (MNC)	Non-compliant (NC)	Not applicable	
18	Rules of CIS and client protection	X					Segregation and safekeeping of CIS assets; limits on leverage
19	Disclosure	X					Disclosure requirements mirror those of U.K.
20	Asset valuation and pricing	X					CIS manager required to publish issue, sale, redemption prices regularly
	Market Intermediaries						
21	Minimum entry standards	X					FSO 89 , Section 9 regulates entry and licensing
22	Capital and other prudential requirements	X					Subject to EU's Capital Adequacy Directive, must report and meet net capital requirements
23	Compliance with standards for internal organization		X				Must keep compliance manual and compliance record, report breaches; but lack of onsite inspections is weakness
24	Procedures to deal with failure	X					
	Market Regulation						
25	Oversight of exchanges and trading systems					X	FSO never rec'd application for exchange or trading system, does not anticipate getting one
26	Supervision of exchanges and trading systems					X	
27	Transparency of trading					X	
28	Detect and deter unfair trading practices					X	
29	Risk management					X	
30	Clearing and settlement system					X	

VII. ASSESSMENT OF GOOD PRACTICES WITH RESPECT TO COMPANIES AND COMPANY SERVICE PROVIDERS, TRUSTS AND TRUST SERVICE PROVIDERS

A. Introduction

158. There is no international group of company and trust regulators and there are no international standards concerning the regulation and supervision of companies, company services providers, trusts and trust services providers. These issues have been raised, from time to time, by many offshore jurisdictions that we have visited. It has also been pointed out that many onshore jurisdictions do not regulate these activities.

159. However, since the business of company and trust registration and administration is significant in many offshore jurisdictions, we must make some judgment about the adequacy of the legislation, regulation and supervision of these activities.

160. The OECD publication, "Principles of Corporate Governance," focus on the management of public companies. It includes principles relating to the rights of shareholders; equitable treatment of shareholders; disclosure and transparency; and responsibilities of the board of directors. These principles are not applicable to trusts and are not directly applicable to privately held trading or holding companies, which are typical of the "international business entities," incorporated in offshore jurisdictions. Most of these entities are private and are formed by nonresident individuals so as to hold various kinds of business interests outside the jurisdiction. Complex structures are not uncommon, sometimes with a trust as the umbrella entity.

161. Recently, two well-publicized reviews of certain offshore financial centers have been conducted. Each review included a substantive assessment of companies; company services providers, trusts and trust services providers. [Review of Financial Regulation in the Crown Dependencies—November 1998 (better known as the Edwards Report) and the more recent KPMG Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda, October 2000]. In both reports, some broad general principles were applied, explicitly and implicitly, as guides as to what can be considered good practices.

162. These principles bear a significant resemblance to regulatory principles established by international bodies in relation to particular activities. For example, one such similarity concerns the principles established by Basel, FATF, and IOSCO that financial institutions should know their customers. These principles should apply with equal relevance to providers of services to trusts and companies.

163. The issue can be summed up by stating that regulatory and law enforcement agencies must be able to obtain key information about trusts and companies incorporated within their jurisdiction. This implies that they should be able to obtain details of the ultimate beneficial owner and not simply the name of the person who set up the structure. There should also be gateways through which non-public information on beneficial ownership and control are shared with other regulators and law enforcement authorities—both domestically and

internationally—for regulatory purposes or for investigating criminal activities. This alone is not likely to stop the abuse of the system but will reduce the scope for abuse of company and trust structures.

B. Companies

Introduction

164. There are approximately 28,500 active companies registered under the Companies Ordinance. Out of these 8,800 are exempt companies. In each of the past three years, an average of 1,990 exempt companies were registered and an average of 1,138 exempt companies were removed from the active list. Relative to a number of other offshore financial centers, Gibraltar's corporate business is modest in size.

165. Gibraltar does not have any distinct or separate legislation that caters specifically for International Business Companies (IBC's). The only corporate legislation that draws some parallel to IBC's is the Companies (Taxation & Concessions) Ordinance.

166. The legislation makes provision for exempt tax status, which in essence is a corporate offshore vehicle. The Exempt Company can be ordinarily resident in Gibraltar, nonresident or registered as a foreign company. All Exempt Companies are initially registered or incorporated under the Companies Ordinance.

167. While no specific information is required to be maintained on the main geographical markets for Gibraltar companies, nor on the uses to which such companies are put, it is apparent that the uses of these companies are similar to those of corporate vehicles incorporated in other offshore jurisdictions (asset and private investment holdings). Beneficial owners of these entities come from all over the world, the majority from Europe.

168. Companies House Gibraltar is the agency in charge of the registration of all companies in Gibraltar. The responsibilities and objectives of the agency regarding company registration are contained in the Companies Ordinance 1930, which was modeled on the U.K. Company Law. These laws were updated as recently as the January 1, 2000. The Registrar of companies reports to the Financial and Development Secretary and the Department of Trade and Industry.

169. The Registrar's primary responsibility is ensuring compliance with filing requirements. The Registrar has the power and authority to request any information that the Companies Ordinance states that must be supplied by the company to the Registry. The Companies Registry has 16 staff including the Registrar. Over half the staff possess more than seven years experience in company formation and law, and a number of the staff are suitably qualified. The registry maintains ongoing staff training programs.

170. The Registrar has sole responsibility for registering companies, apart from approval of the company name that is subject to the Government of Gibraltar criteria. The Registrar has every right to refuse registration if the entry criteria are not fulfilled, or if the information provided is inadequate or false, or if in his/her opinion it is against the public interest, undesirable or against public morals, but that decision is subject to review by the Supreme Court of Gibraltar.

171. When reviewing company registration applications, it is usual for the database at Companies House to be checked and if necessary also checked with the Financial Services Commission and/or the Financial and Development Secretary.

172. Every company must have a registered office in Gibraltar. Companies incorporated elsewhere but operating in Gibraltar must register at Companies House and have the same filing requirements, including the duty to file accounts, as those incorporated in Gibraltar. There are different types of companies, (i.e., private and public companies), but the procedure for registration in all cases is similar.

173. The minimum number of persons required to form a company is one. Similarly, the minimum number of directors required under the law is also one. All information about directors and officers are a public record and available to all members of the public.

174. All information regarding share transfers form part of the public record and must be supplied to the Registrar with each Annual Return.

175. Anti-Money Laundering requirements apply to all persons in Gibraltar, including the Registrar. Where the beneficial owner is not known, then, customer identity requirements are considered the responsibility of the company manager or the professional incorporating the company and not the responsibility of the Registrar.

176. There are no international standards concerning the regulation of companies. However, some broad principles that are listed in italics, below, are becoming more widely accepted and are among those that have been used by some authorities in assessing good practices.

177. Gibraltar is observant of emerging good practices that relate to the regulation of companies. These are a few areas, however, where the authorities should consider “fine tuning” the system. The recommended improvements are stated under the specific “good practice”

Good Practice

178. *The authorities should have a means of establishing, where necessary, who are the principals behind the companies that are incorporated in their jurisdiction. They should be able to identify, at all times, the shareholders and directors of a company and the ultimate beneficial owners of a company's shares. That implies that there must be disclosure at registration and disclosure of any subsequent changes. This implicitly means that bearer*

shares should be discouraged. If they are permitted, effective custody arrangements should be in place. While there may be legitimate reasons for their use, these instruments are often abused.

179. Gibraltar follows good practice. The authorities take measures to establish the identity of the shareholders, directors and ultimate beneficial owners of companies incorporated in Gibraltar.

180. While bearer shares are not permitted under Gibraltar law, the issue of share warrants to bearer is permissible. In Gibraltar, very few share warrants to “bearer” are issued and outstanding, and invariably they are immobilized. Both shares and warrants to bearer provide anonymity and are open to abuse by individuals who use corporate vehicles with criminal intent. Although there are a number of legitimate uses for bearer share warrants, good practice requires their effective control, by either registration or immobilization.

Good Practice

181. *The authorities should have a means of access, where necessary, to basic financial information relevant to the activities of companies. Without this, the nature, scale and purpose of the activities of individual companies are not likely to be known.*

182. Gibraltar follows good practice.

Good Practice

183. *Directors must fulfill their obligations effectively and should not be able to assign their responsibilities to others. This means that while directors may be able to assign their functions to others they remain ultimately responsible.*

184. Gibraltar follows good practice.

Good Practice

185. *The Authorities must have the power to petition the courts to strike-off and/or wind up companies for due cause.*

186. Gibraltar follows good practice.

C. Trusts

Introduction

187. There are currently over 2000 trusts under administration in or from within Gibraltar by a variety of licensed service providers.

188. The English Law (Application) Ordinance applies English principles of equity to Gibraltar. It is these principles that govern the Law of Trust in Gibraltar.

189. There are the same types of trusts in Gibraltar as there are in the United Kingdom, that is, accumulation and maintenance settlements, non-interest in possession settlements, interest in possession settlements, bare trusts, discretionary trusts, and charitable trusts.

190. Trust Legislation in Gibraltar does not differ to any marked extent from trust legislation in other offshore and onshore jurisdictions, including the United Kingdom, with English equitable principles being applied by the English Law (Application) Ordinance. It is these principles that essentially govern the Law of Trust in Gibraltar.

191. Trusts, while being widely used for various purposes, are generally not regulated.

192. There are no international standards concerning the regulation of trusts. However, some broad principles that are listed below are among those that are developing and have been used by some authorities in assessing good practice.

193. Gibraltar is observant of emerging good practices that relate to trusts. These are a few areas, however, where improvements would be beneficial. The recommended improvements are stated under the specific “good practice”

Good Practice

194. *Trusts should not be used to obscure the true ownership of assets, defraud creditors or frustrate legitimate claims. This implies that “flee clauses” that serve clearly illegitimate purposes should be prohibited. (For example, if the triggering event is the commencement of criminal proceedings or an enforcement action against the settlor of the trust or against the trustee this should not be allowed).*

195. The legislation does not proscribe the inclusion of “flee causes” in the trust instrument and, therefore, trusts in Gibraltar may include such clauses. It is usual for the vast majority of such clauses to be triggered on the occasions of natural disasters, civil unrest, political instability, revolution, and other similar events. Such clauses might also be used potentially to place assets that are derived from criminal or illicit activities out of the reach of law enforcement authorities.

196. The Gibraltar authorities stance, based on legal advice, is that although there are no restrictions on any specific events that might trigger a flee clause, there are certain events that were they to be included, would render it as unenforceable as contrary to public policy, for example, if the “flee clause” were triggered by the occurrence of a criminal act or fraud.

Recommendation

Despite the legal assurances, we recommend that as “flee clauses” are an issue of general application, trust legislation should be amended to restrict their use.

Good Practice

197. *The authorities should be able to ascertain quickly and efficiently the true owners of assets held in trust for the purposes of a criminal investigation.*

198. Gibraltar follows good practice.

Good Practice

199. *The authorities should be able to identify the settlor, beneficiaries, protector and custodian (where applicable) of a trust, and to obtain a copy of the trust instrument for the purposes of a criminal investigation.*

200. Gibraltar follows good practice.

Good Practice

Financial reporting and audit by licensee of clients accounts

201. There is a range of abuses to a trust that could possibly arise as a result of unscrupulous behavior by the settlor, the trustee, or both.

202. The risk of such abuse can be reduced if the conduct and the administration of the trust can be monitored. Professional trustees by the nature of their duties and responsibilities must be accountable for their actions, particularly if negligence or default is willful.

203. The beneficiaries have a right to expect a paid trustee, who is licensed and regulated to administer the terms of the trust with care, prudence and probity. Similarly, the prime beneficiaries, the co-trustee and any protector are entitled call on the trustee for the production of annual accounts in order to review the stewardship of the trust to ensure that the trust is being properly administered and the terms of the trust adhered to. Such reporting, on an annual basis should act as a deterrent and reduce the risk of misappropriation of the trust funds by unscrupulous trustees. We consider this to be good practice.

204. The cost of such reporting should always be borne by the trustee unless otherwise provided for in the trust deed. The cost of an external audit however is an administration expense and borne by the trust.

Recommendation

The practice of conducting an annual audit by a licensee of clients' accounts is becoming more widely accepted and Gibraltar may want to consider whether to implement this developing practice.

D. Company and Trust Services Providers

Introduction

205. There are 83 groups who are licensed to provide “controlled activities business” of those 47 are licensed to act as professional trustees. Numbers are given in terms of groups on the basis that this business sector usually operates with a structure comprised of various related companies that, as a group, provide the licensable services.

206. Gibraltar has been a pioneer in the supervision and regulation of Professional Trusteeship and Company Management service providers. Schedule 3 to the Financial Services Ordinance 1989 (“the Ordinance”) describes various “controlled activities” that are to be licensed and supervised. Company Management is defined as the provision of managerial services for profit or reward in or from Gibraltar, whereby a person is a director for, or a shareholder of, a company, or when control over the whole or substantial part of the assets of the company is vested in the management company. Professional trusteeship is the holding out as a professional trustee for profit or reward, or soliciting for business as such, in or from within Gibraltar.

207. The ordinance also provides the criteria and standards that must be taken into consideration when the application is being considered (Section 9). In addition to providing the legislative framework for the licensing and regulation of the service providers (controlled activities), the 1989 Ordinance also provides for the creation of a set of supplementary regulations Financial Services Regulations. These regulations cover such issues as conduct of business, accounting and financial, penalty fees, advertising licensing fees and classification of business.

208. Any person who provides professional trusteeship and/or company management services by way of business, to be in possession of a valid license issued under Section 8 of the above Ordinance.

209. Before granting a license the Commissioner is required, among other things:

- **to consider whether the applicant, and any person associated with the applicant, is a “fit and proper” person to carry on the business proposed; and**
- **to consider the manner in which the business will be carried on, including meeting the requirement that at least two competent individuals direct the business of the licensee (the traditional “four eyes” principle).**

210. The “fit and proper” criteria cover both technical competence and integrity. The second requirement covers all aspects of the operation including the human and systems resources available, the records to be kept, and the controls to be put in place to ensure compliance with regulatory obligations. All licensees must have a physical presence in Gibraltar. Applicants are also required to advertise in Gibraltar that they are applying for a

license, and the Commissioner must consider any representations he receives from the public in response to these advertisements. All licensees must display their licenses in their premises.

211. Once a license has been granted, the licensee is required to advise the Commissioner of any material changes to the information given at the time of licensing. So, for instance, changes of control, appointment of new directors and managers (for which consent is required from the Commissioner) are all captured within the on-going supervisory process. Licensees must also submit their audited financial statements and, at the same time, their auditors must report to the Commissioner on compliance with specified regulatory obligations.

212. The Commission's staff conducts inspection visits to ensure that licensees are continuing to adhere to all the regulations applicable to the type(s) of business for which they have been licensed. The process includes a review of a licensee's systems and controls and of their 'know your customer' ('KYC) procedures. It includes a review of files to confirm the operation of the system and KYC disciplines. The fundamental continuing supervisory process is thus an "onsite" inspection-based process. The Commission also issues Newsletters, from time to time, advising licensees on what it considers to be "best market practice". Adherence to these standards forms part of the onsite review process.

213. The enforcement powers against a licensed firm or unlicensed operator, available to the Commissioner under the 1989 Ordinance, include powers to obtain information, documents, suspension, and cancellation of licenses.

Assessment

214. There are no international standards concerning the regulation and supervision of providers of company and/or trust services. However, some offshore jurisdictions have extended regulation to persons who perform various services in connection with setting up and administering of companies (Company Service Providers) and trusts (Trust Service Providers).

215. One of the arguments for regulating company and trust service providers is that many services they perform are often financial or quasi-financial in nature and, thus, the provision of such services should be subject to regulation such as those existing in the financial sector.

216. We consider the inclusion by Gibraltar of Trust Service Providers (TSPs) and Company Service Providers (CSPs) as a controlled and regulated activity to be a positive feature of the 1989 Ordinance that other jurisdictions should be encouraged to follow.

217. Some broad principles that are listed in italics below are among those that have been used by some authorities in assessing good practices.

218. Gibraltar is observant of good practices with respect to the regulation and supervision of company and trust service providers. However, there are a few areas where some fine-tuning would improve the system.

219. It is our view that the current staffing levels cannot support the level of supervision that should take place to fulfill the good practice standards.

220. Currently, one full-time and one part-time member of staff are involved in the line supervision of 47 TSPs and 77 CSPs. We are advised that the number of onsite reviews that have been conducted in the last two years is 44 (28 in 1999 and 16 in 2000). On the basis of these figures, it should take six years to complete the onsite review of all fiduciary service providers. Progress can be accelerated with increased resources. We have not taken into consideration either focused visits or prudential meetings that should be held at least on an annual basis.

Recommendation

We recommend that an additional analyst be engaged to augment the division's resources.

Good Practice

221. *Everyone who provides company and/or trust services should be licensed and subject to identical effective regulation. It should be an offense to provide such services without registration/license and to provide false or misleading information as part of the application. This implies that professionals such as lawyers and accountants who provide these services must be registered/licensed. Self-regulation by professional bodies, although desirable, is not sufficient.*

222. We are also pleased to note that a licensed TSP's and CSP shall have a minimum of two directors. We believe that the "four eyes" control for all licensed service providers accords with good international practices.

223. Some significant areas of company management business, including the formation of companies and the provision of registered office services, are currently outside the scope of the legislation and of the regulatory net. We understand that, following representations from the company management business sector, the Government of Gibraltar has agreed to an extension of activities that constitute licensable company management services and a draft of the amending legislation is currently awaited.

224. The effect of the proposed legislative changes will be that all company manager services, even those that are currently unregulated or classified as restricted, will need to satisfy all the requirements that are necessary for a full company manager license. Thus, even where an applicant is merely seeking to provide limited company formation services, the

applicant will be required to demonstrate the competence and capability to undertake the full range of company manager services.

Recommendation

In the event that the proposed amendments become law, then our concerns will have been suitably addressed.

225. Any person(s) entity or institutions requiring a license to provide financial services must satisfy the FSC that the standards of fitness and propriety have been met. The term “fit and proper” includes amongst other considerations the concepts of honesty, solvency and competence.

Recommendation

We recommend that the definition “fit and proper” should be contained in amendments to existing regulations currently being drafted to ensure that the standards of assessment remain constant. In addition, we recommend that the professional qualifications of those who seek to provide trustee services should be relevant to the industry. This is particularly important as the knowledge and levels of professional expertise needed to discharge the duties and responsibilities of a trusteeship is very different to that required for the provision of company management services, and currently there is no distinction.

226. The criteria for the granting of a license are comprehensive and meet good practice. In considering new applications for CSP licenses, the staff of the FSC uses checklists as an “Aide-Mémoire” to ensure that all information and documentation has been provided. Whilst checklists serve a purpose, their application is limited.

Recommendation

We recommend that the use of such checklists be expanded into a more comprehensive Applications Manual that provides qualitative guidance on assessing an application, such as: assessing a business plan, and assessing and verifying references and other evidence of fit and proper criteria having been met. Such an applications manual could also provide the foundation for a manual of offsite Inspection procedures and include such issues as financial reporting, due diligence, know your customer, segregation of client monies and source of funds, as well as providing a set of routine “day to day” offsite procedures.

227. With the exception of any person whose name, address, and qualifications are contained in Part I of the Register of Auditors kept pursuant to the Auditors Registration Ordinance and those barristers or solicitors admitted and enrolled under the Supreme Court Ordinance, who are specifically exempted by law, all other persons who provide professional trustee services or company management services in the jurisdiction are required to be licensed.

Recommendation

Developing international practice requires that all those engaged in the controlled activities market should be licensed and subject to effective regulation. A move to bring such professionals into licensing appears a desirable thing to do.

Good Practice

228. *The regulator should have effective and independent enforcement powers, including the power to monitor and supervise licensed company services providers, to inspect their activities, to investigate potential breaches of rules, regulations and laws and to petition the Court to wind up a company and/or trust services provider.*

229. In order to monitor compliance of TSPs and CSPs with the law and with the terms of their licenses the FSC has in place a regulatory environment for the supervision of controlled activities, both onsite and offsite. This environment should include an offsite manual of routine procedures that covers the following areas:

- granting, surrender and revocation of TSP's and CSP licenses;
- changes in ownership of shares in a trust company;
- appointment of directors;
- duties of a licensee; and
- enforcement powers.

230. The day-to-day routine of the offsite supervisor should also be documented in the offsite manual. Ideally this should provide "on the job training" and instruction to the supervisor in order to maximize the effectiveness of the supervisors regulatory tools, in particularly the review of financial statements and the regulatory returns. The regulatory returns could be improved to obtain more qualitative information that would enable the offsite supervisory process to be able to assess the competence and the integrity of the licensee to a much greater extent. This should lead to an improvement in the quality of the offsite supervision of the licensees.

Recommendation

We recommend the introduction of an enhanced offsite inspection manual along the lines outlined above.

231. As fiduciary assets are not reflected in the annual financial reporting of the TSP licensee, regulatory prudence would indicate more reliance being placed on the onsite inspection process than might otherwise be necessary. While there are no international standards governing the regularity of visits, we consider that an onsite inspection program be structured on a minimum three year cycle if it is to be effective. This does not include either focused visits or prudential meetings. All licensed service providers within the controlled activities market should primarily be concerned with source of funds/assets, whether they flow into a trust or a managed company. This requires the service provider to carry out due diligence to verify the identity of the client/settlor. Only sample testing of client files by, the regulator, at the premises of the licensee can establish whether the service provider is compliant whilst the regulatory offsite function serves various purposes, it cannot be an effective substitute for the onsite process.

232. Although the FSC has conducted a number of visits in their onsite inspection program in respect of Trust and Company Service Providers, we do not consider that it is fully effective. One full-time officer and an assistant supervisor who provides part-time assistance are responsible for the supervision of all CSP licensees, in addition to all TSP licensees. In our view this level of staffing is inadequate to support a robust onsite supervision program.

233. We also consider that insufficient time is currently devoted to the onsite inspections, which should take between four to five days to complete. Sample testing of clients files should occupy at least two of the days. We also consider that prudential visits/meetings should not be used, as part of the onsite inspection program, and those prudential visits should take place at least on an annual basis.

234. An effective onsite inspection program should include an inspection manual and cover pre-examination and past examination procedures. Ideally the manual should contain checklists covering the following areas:

- management and supervision;
- operations and control;
- audit (internal and external);
- account administration;
- conflict of interests;
- business volumes and development; and
- compliance.

Recommendation

We recommend the introduction of an enhanced onsite inspection manual along the lines outlined above.

235. It is usual for the regulatory authority to verify that all licensees have management information systems which determine on a timely basis that business risks are adequately monitored and that senior management of the licensee understands the risks inherent in its business

Recommendation

The trust service business can be particularly risk prone and, at the time of the licensing application, it would be most unlikely that any of the probable risks that could easily would have been identifiable, either by senior management or the regulator; risks such as loss of staff, loss of existing business, loss of new business markets. Such issues are unlikely to be identified in the offsite review process and unless the rate and quality of onsite inspections improves, there could well be a considerable time gap before the licensee's problems come to the regulators attention. This reinforces the need for an additional analyst.

236. The Financial Services Ordinance 1989 provides for the introduction of regulations for the petitioning of the winding up of a licensee. Such regulations have not been enacted. The Commissioner is currently in consultation with the Government of Gibraltar with a view to putting these regulations into effect as soon as possible.

Recommendation

We support the introduction of such legislation.

Good Practice

237. The regulator should be able to apply a range of appropriate sanctions including the revocation of a license and the imposition of meaningful civil money penalties.

238. The FSC has a wide range of powers. However we believe that powers relating to the conduct of directors of licensed entities should be strengthened. The statutory duties of directors are set out in the Companies Ordinance. In addition, there are common law duties of directors similar to those in the United Kingdom. The Financial Services Commission has also issued a newsletter on the General Duties and Responsibilities of Directors of licensed firms. However, there does not appear to be any procedures in place whereby the director's actions and activities are monitored and the regulator can assess on a periodical basis whether the director still continues to meet the fit and proper criteria. Directors are required to file an annual statement of compliance and were this found to be inaccurate following on onsite review there should be prima facie grounds against the institution.

Recommendation

When a director of a licensed company ceases to perform his/her duties in a proper manner or is no longer fit to manage the company's affairs, a legislative provision should be in place so as to provide for disqualification. In those instances where the director is involved in fraud or other criminal activity such disqualification should extend to directorship of all companies licensed by the FSC.

Good Practice

239. *Company and trust services providers should have in place effective anti-money laundering measures, including know your customer rules, record keeping, and staff training procedures.*

240. The Criminal Justice Ordinance 1995 (CJO) requires relevant financial businesses put in place measures for the prevention of money laundering. Although the legislation does not impose such requirements on company managers who do not undertake relevant financial business, the FSC nevertheless takes the view that best market practice requires that all licensees comply with the legislation and the procedures described in the Gibraltar Anti-Money Laundering Guidance Notes. It is proposed in a consultation paper (Amendment to the Anti-Money Laundering Regime), dated March 1, 2000, that the definition of "relevant financial business" for the purposes of the Criminal Justice Ordinance (CJO) should be extended to include all company management and professional trusteeships.

Recommendation

We recommend that the proposal in the consultation paper be adopted. This modification would meet the standards of developing international best practices.

In cases where business is conducted through introductions by other professional intermediaries operating in a different jurisdiction, company services providers should apply KYC rules in such a manner as to be able to identify the ultimate beneficial owners of a company. Reliance on an intermediary for the purpose of providing an additional layer of protection for a customer, even though legitimate in certain circumstances may significantly undermine the ability of the authorities to obtain the required information about the ultimate beneficial owners of the company in the fulfillment of their regulatory functions.

Good Practice

241. *Law enforcement and regulatory authorities should be able to ascertain, quickly and efficiently, the identity of directors of and the shareholders in a company serviced by a company services provider and the beneficial owners of the shares in such a company for the purposes of a criminal investigation.*

242. Gibraltar adheres to good practice.

Good practice

243. *Ongoing monitoring of company services providers is important since offshore jurisdictions are often accused of poor regulation and supervision.*

244. The Financial Services (Conduct of Business) Regulations 1991 provides the core principles by which licensed company services providers must act in relation to their business and their dealings with customers and observe high standards of integrity and fair dealing and act with due care and diligence in the best interests of their customers and the integrity of the industry.

245. In order that the business conduct principles accord with developing international practices certain legislative enhancements are required. The requisite amendment and arrangement of rules have in fact been proposed by the FSC and incorporate many good practices that were not previously codified.

Recommendation

We recommend the early adoption of those changes.

246. Development of a compliance function (and compliance culture) within firms providing company management and trust services is strongly recommended. We recognize that the scope to have such a independent function, suitably independent of the Directors, within small service providers with limited personnel, may at this stage be rather limited.

247. The FSC indicated that recently there has been a resolution to establish in Gibraltar a branch of the Compliance Institute. This initiative was endorsed by the FSC and promoted by the Gibraltar Bankers Association. While starting in the banking sector, the aim is that it will branch out and embrace compliance across all sectors of the market in Gibraltar and lead to the establishment of a professional and qualified cadre of compliance officers within the jurisdiction. In addition, the FSC mentioned us that it was considering a proposal to allow for the outsourcing of compliance in the company and trust sectors, much in the same way as out-sourcing of internal audit in other sectors and in other jurisdictions has developed.

Recommendation

We endorse both initiatives.