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To: Members of the Executive Board

From: The Acting Secretary

Subject: **Isle of Man—Financial System Stability Assessment—Update**

Attached for the **information** of the Executive Directors is an update on the Financial System Stability Assessment for the Isle of Man. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Isle of Man indicating whether or not they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Hardy, MCM (ext. 38490).

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ISLE OF MAN

Financial System Stability Assessment Update

Prepared by the Monetary and Capital Markets Department

Approved by Hervé Ferhani

August 19, 2009

This report presents the conclusions of the Financial Sector Assessment Program (FSAP) Update mission that visited the Isle of Man (IOM), September 9–18, 2008. The mission comprised Daniel Hardy (mission chief), Andrea Maechler, Ian Tower (all MCM/IMF), Peter Kruschel (BaFin, banking supervision expert), and Ronald MacDonald (banking supervision expert). The mission worked closely with the overlapping LEG mission (led by Terence Donovan) that conducted an assessment of the Financial Action Task Force (FATF) anti-money laundering and combating the financing of terrorism (AML/CFT) standards. The mission received excellent cooperation and support from the authorities.

The main findings of the FSAP Update are that:

- The global financial crisis has begun to have an effect on the island, largely because of the travails of parent banking groups. Risks arising from the IOM operations seem well contained.
- The regular review of the soundness of parent financial institutions is critical, and will require continued close cooperation with home supervisors. Regulations on exposures to related parties and liquidity need to take more into account risks from exposure to parent institutions.
- Contingency plans and the depositor compensation scheme need to be refined. The authorities should develop more system-wide monitoring of risks.
- Financial sector regulation and supervision are generally of a high standard, and supervisory efforts are concentrated in those areas most relevant to the activities of financial institutions on the IOM. Compared to the situation at the time of the 2003 assessment, the financial sector supervisors now operate with more independence and accountability, and a considerable amount of on-site supervision is conducted. Some specific improvements are recommended in the report and the attached Reports on Observance of Standards and Codes (ROSCs).

The main author of this report is Daniel Hardy with input from the other members of the FSAP Update team.

FSAP assessments are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAP assessments do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

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GLOSSARY

AG	Attorney General
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCP	Basel Core Principles for Effective Banking Supervision
CAR	Capital adequacy ratio
CIS	Collective investment scheme
CDD	Customer due diligence
CSP	Corporate service provider
DCS	Depositors' compensation scheme
DHA	Department of Home Affairs
DNFBPs	Designated Nonfinancial Businesses and Professionals
EU	European Union
FATF	Financial Action Task Force
FCU	Financial Crime Unit
FIU	Financial intelligence unit
FSIs	Financial soundness indicators
FSA 2008	Financial Services Act 2008
FSAP	Financial Sector Assessment Program
FSC	Financial Supervision Commission
FT	Terrorism financing
GWP	Gross written premiums
GSC	Gambling Supervision Commission
IA 2008	Insurance Act 2008
IAIS ICP	International Association of Insurance Supervisors Insurance Core Principles
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IOM	Isle of Man
IPA	Insurance and Pensions Authority
IT	Information technology
LOLR	Lender of last resort
ML	Money laundering
MLA	Mutual legal assistance
MOU	Memorandum of understanding
MVT	Money and value transfer
NPO	Nonprofit organizations
OFC	Offshore Financial Center
PEPs	Politically exposed persons
POCA 2008	Proceeds of Crime Act 2008
RAR	Risk asset ratio
ROSC	Reports on Observance of Standards and Code
RMM	Required minimum margin

STR	Suspicious transaction report
TIEA	Tax Information Exchange Agreement
The Code	Banking (General Practice) Regulatory Code 2005
The Rulebook	Financial Services Rule Book 2008
TSPs	Trust service providers
Tynwald	Parliament of the Isle of Man
UK	United Kingdom
UN	United Nations

EXECUTIVE SUMMARY AND POLICY AGENDA

This report updates the findings of the 2003 assessment under the Offshore Financial Center (OFC) program, and suggests priorities going forward. The analysis is based mainly on information available at the time of the September 2008 mission; developments since then are taken into account but also confirm the importance of the identified underlying issues.

Financial sector stability has been challenged in recent months by the global turmoil, which has begun to affect some institutions on the IOM. These effects became pronounced in the fall of 2008, when several foreign parent institutions came under extreme strain: some of them have been taken over or received government support, and one local bank is now in liquidation because of the collapse of its parent. The soundness of locally-licensed banks and insurance companies depends on that of their parent institutions; so long as they remain strong, stress tests undertaken as part of the FSAP Update suggest that local institutions would be resilient even to extreme shocks. The authorities can enhance their analysis of trends in systemic stability and overall performance, and peer group analysis by the regular compilation of additional statistics, for example, on aggregate financial soundness indicators (FSIs) and balance sheets.

The authorities need to continue to press ahead with the preparation of contingency plans. These plans must take into account structural features such as the dependence of most banks on large parent institutions (for risk management, and operations as well as placement of funds), and IOM's limited resources. The depositors' compensation scheme (DCS) has recently been expanded in the context of the current global turmoil, but is to be reviewed again in due course. The review will need to take into account the evolution of deposit guarantee schemes in advanced economies, and the IOM's particular objectives and constraints (for example, the large size of the financial sector relative to the domestic economy). After the crisis has passed, the DCS should be amended to better relate its contingent liabilities to available resources, while ensuring that all investors are fully informed of coverage limits. In addition, the authorities could consider developing a dedicated bank insolvency regime.

Financial sector regulation and supervision are generally of a high standard, and supervisory efforts are concentrated in those areas most relevant to the activities of financial institutions on the IOM. The mission conducted detailed assessments of observance of the Basel Committee Core Principles for Effective Banking Supervision (BCP), the International Association of Insurance Supervisors Insurance Core Principles (IAIS ICP), and the FATF 40+9 Recommendations on AML/CFT. The level of observance of these principles is high in terms of laws and regulations, supervisory implementation, and the practices of financial institutions.

The financial sector supervisors—the Financial Supervision Commission (FSC) and the Insurance and Pensions Authority (IPA)—operate with considerable independence, and a variety of mechanisms are in place to ensure their accountability. Recent legal changes have enhanced this independence and accountability, although according to the letter of the law the FSC and IPA are still potentially exposed to government and political pressures due to certain legal provisions, such as those on the dismissal of board members. Furthermore, the agencies depend on government for their budgets and staffing levels. To date this does not seem to have been a constraint on effective supervision, but it may become more problematic as the financial system becomes more complex (for example, with the potential application of Solvency II requirements in the insurance sector).

The FSC faces a conundrum because the major banks are subsidiaries of large international financial groups, to which they provide financing: risks regarding these groups are normally minimal, but they are highly concentrated. Indeed, many banks are located on the IOM precisely in order to channel deposits to parent groups. This close relationship is a risk-mitigant in normal times, but also a powerful risk transmittal mechanism in exceptional periods, as seen recently. The FSC is currently reconsidering how best to balance prudential requirements for liquidity and exposure to related parties against business needs that entail high exposures to the parent. Policy should not take parent support for granted, and—in cooperation with home supervisors—the FSC will need to keep under review the financial health of parent groups and their ability to support their local subsidiaries. A contrasting need in the insurance sector is the introduction of regulations and procedures to supervise groups of companies, a small number of which are headquartered on the IOM.

Other areas for further improvement may become more important as the financial sector evolves. They include: (a) developing criteria for assessing major acquisitions of financial and nonfinancial subsidiaries by local banks; (b) the introduction of explicit rules on corporate governance, internal controls, and risk management for insurance companies; and (c) disclosure requirements for insurers, especially non-captives.

The emphasis of regulations and supervision of the collective investment scheme (CIS), pension, and fiduciary service provider sectors has shifted toward the close oversight of service providers rather than that of individual products. Provisions on CIS have been adjusted to make them more suited to professional and institutional investors, where the IOM is seen as having a comparative advantage relative to the retail market. Supervisory attention focuses on the providers of related services and products aimed at retail investors. Fiduciaries are supervised on a regular basis and operate within an up-to-date legal and regulatory framework.

The IOM has brought its AML/CFT preventive measures largely into compliance with the FATF Recommendations. All IOM financial institutions are well-supervised for AML/CFT purposes. The Financial Crime Unit (FCU), acting as the financial intelligence

unit (FIU), performs its role adequately, but will require additional resources. The IOM authorities actively engage in international cooperation.

A list of main recommendations is attached. The recommendations are generally not time-sensitive, but many could be implemented within 6 to 12 months. These recommendations are broadly consistent with the priorities already identified by the authorities and in most cases policy action is already under way.

Main Recommendations

High priority	
General	<ul style="list-style-type: none"> • Compile and publish more systematically statistics on financial sector activities and soundness indicators.
Banking	<ul style="list-style-type: none"> • Revise regulations on exposures to related parties and liquidity to take more into account risks from exposure to parent institutions, while accommodating business needs. • In cooperation with home supervisors, confirm on a regular basis that parent banks have the capacity to support local subsidiaries. • Continue to develop contingency plans to deal with a variety of stress situations. • Keep the DCS under review with a view to maximizing its contribution to stability and social objectives, and, at an appropriate time, adjusting coverage levels to better limit contingent liabilities.
Insurance	<ul style="list-style-type: none"> • Issue regulations and develop procedures to achieve effective group supervision.
Medium priority	
General	<ul style="list-style-type: none"> • Strengthen capacity to assess system-wide vulnerabilities, including through stress testing. • Introduce explicit criteria for dismissal of FSC and IPA Commissioners, and require publication of the explanation.
Banking	<ul style="list-style-type: none"> • Develop (and publish) cross-bank comparisons and system-wide stability analysis.
Insurance	<ul style="list-style-type: none"> • Introduce explicit standards on corporate governance for insurance companies and related issues (internal controls, risk assessment and risk management). • Require (noncaptive) insurance companies to disclose information on their financial position to stakeholders, including policyholders.

I. INTRODUCTION

A. Purpose of the FSAP Update

1. **The ongoing refinement of the IOM’s regulatory framework in recent years and the growth in the financial sector have motivated an update of the assessment that was conducted in 2002 under the Fund’s OFC program and finalized in 2003.** Furthermore, the recent integration of the OFC program into the FSAP (Executive Board meeting 08/48 on May 30, 2008) has widened the scope of the assessment to include stability-related issues. This report, therefore, covers both the regulatory and supervisory system—mainly for the banking and insurance sectors—and matters relating to the soundness of the financial system and its ability to cope with stress situations. The assessment is based on information available at the time of the September 2008 mission, updated to reflect documented regulatory and economic developments since then.

B. Context

2. **The IOM is a British Crown Dependency, and as such it is not part of the United Kingdom (UK) and has its own parliament (Tynwald), legal and regulatory system, and tax regime.**¹ However, its economy is highly oriented toward that of the UK. There is a customs and value added tax union with the UK, and the pound Sterling is the currency.²

3. **The Manx economy has performed well in recent years.** Annual GDP growth has averaged over 8 percent over the last decade. Unemployment is negligible. Inflation has been in line with that of the UK, and in mid-2008 was about 4 percent. The government is required to budget for a surplus, which has allowed it to build up reserves. Average residential house prices rose fairly steadily at about 8 percent per year during 2003–07. The recent financial markets turmoil and the slowdown in Europe are likely to affect the economy going forward.

4. **The basis of this strong performance was the growth of the financial sector.** The main activities are banking, investment business, life and “captive” insurance, fund management, and fiduciary services (Statistical Appendix).³ Banking generates almost one-fifth of the IOM’s GDP, and the combined financial services makes up more than

¹ The other Crown Dependencies are Guernsey and Jersey.

² Seigniorage is earned on the issue of Manx banknotes.

³ A “captive” is defined by the IAIS as “an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities and only a small part if any of its risk exposure is related to providing insurance or reinsurance to other parties.”

one-third; professional services, some of which are finance-related, make up another fifth of GDP.⁴ The IOM is in the middle range of OFCs by balance sheet size, being smaller than the other Crown Dependencies in banking, but larger in insurance.

5. **Banking remains the largest component of the financial sector (Table 1).** Most major British banks and building societies have operations on the IOM. In addition to two Manx banks, there are branches and subsidiaries from other European Union (EU) countries (mainly Ireland), and some other countries. Banks' business models are diverse (Tables 2, 3, and 4). One major component is the collection of retail deposits from overseas (for example, from UK nationals working in third countries, and from non-EU nationals resident in the UK but not domiciled there) or from institutions such as trusts. These deposits are often on-lent to parent banks. The important deposit-collecting function of Manx banks is reflected in their simple balance sheet structure, with intra-group claims accounting for the vast majority of assets. Besides placement with parents and limited lending to the local economy, there is some lending to entities incorporated on the IOM with business elsewhere, and residential mortgages in the UK. Banks do not operate trading books and in almost all cases liquidity is managed by parent banks.

6. **The insurance sector comprises life assurance and captives (Table 5).** The life business, which mainly provides unit-linked savings products (where market risks are borne by the policyholder), underwrites business mostly from policyholders in the UK, the Middle East, and the Far East. The captives include a diverse range of specialist companies. A dedicated regulatory framework for pension schemes was introduced in 2005; the sector is still small (See Table 1).

7. **The CIS sector has been growing rapidly in terms of both number of funds and assets under management (Table 6).** Much of this growth is attributed to the institutional sector, including hedge funds. In most cases, Manx companies concentrate on back office and ancillary services for CIS, rather than active trading and determining the investment strategy.

8. **Providers of fiduciary services contribute importantly to the local economy.** Services provided relate to the establishment or transfer of companies, acting as director or secretary, the maintenance of records and accounts, acting as a trustee, and administering trusts. More than 30,000 companies are registered on the IOM, and Manx corporate service providers (CSPs) and trust service providers (TSPs) administer many more companies and trusts. Sophisticated legal and accountancy services are available in the IOM.

⁴ Efforts have been made to diversify the economy, for example, by promoting light manufacturing, shipping registry, and film industries.

Table 1. Isle of Man: Financial System Structure, 2003–2008

	December 2003			December 2007			December 2008		
	Number	Assets (GBP million)	Percent of total assets	Number	Assets (GBP million)	Percent of total assets	Number	Assets (GBP million)	Percent of total assets
Banking Sector	56	33,499	53.6	44	68,115	48.8	40	73,856	52.9
Joint stock and private banks	34	...	...	26	50,086	35.9	24	52,821	37.8
Subsidiaries of UK banks	22	...	...	13	...	...	9	...	...
Subsidiaries of other EU banks	6	...	...	5	...	...	6	...	...
Building societies (branches)	2	...	...	3	...	...	2	...	...
Bank branches	20	...	...	15	18,029	12.9	14	21,035	15.1
UK	18	...	...	10	...	...	12	...	...
Other EU	0	...	...	3	...	...	2	...	...
Insurance sector	187	23,943	38.3	172	43,654	31.3	169	42,848	30.7
Life insurance companies	18	18,059	28.9	17	38,634	27.7	17	37,457	26.8
Non...life companies	13	1,318	2.1	18	1,143	0.8	14	1,220	0.9
Reinsurance	10	150	0.2	14	500	0.4	16	445	0.3
Captives	146	4,416	7.1	123	3,377	2.4	122	3,725	2.7
Providing 3rd party insurance	17	691	1.1	15	782	0.6	15	806	0.6
Pure captives	129	3,725	6.0	108	2,595	1.9	104	2,920	2.1
Pension funds	...	...	...	450	1,184	0.8	...	...	...
Mutual funds	203	5,040	8.1	464	26,720	19.1	...	...	...
Total financial system	446	62,482	100.0	1,130	139,673	100.0	...	...	...
<i>Memo items:</i>									
Number of company service providers	127			179			204	4/	
Number of trust service providers	...			115			131	4/	
Total employment 2/	...			41,793			...		
Number of employees in the financial sector 3/	...			9,395			...		
Total GDP (GBP millions)	1,229			1,818			...		
Financial sector contribution/GDP (percent) 3/	39.4			39.4			...		
Total financial system assets/GDP (percent)	5,082			7,684			...		

Sources: FSC, IPA, Economic Affairs Division of the Treasury, and staff estimates.

1/ The 2003 banking data exclude overseas branches.

2/ Based on 2006 Census data.

3/ Insurance, banking, finance, and business services.

4/ As of end-January 2009.

Table 2. Isle of Man: Balance Sheet of Domestically Incorporated Banks
(end-2008)

	GBP thousands	In percent of total	In percent of sub- group	In percent of GDP 1/
Total assets	61,657,453	100.0	100.0	3,392.2
Total loans	58,947,774	95.6	95.6	3,243.1
Real Sector Loans	8,023,487	13.0	13.0	441.4
Corporate	2,143,362	3.5	26.7	117.9
Subsidiaries/domestic	1,367,038	2.2	63.8	75.2
Branches	776,324	1.3	36.2	42.7
Retail	1,712,186	2.8	21.3	94.2
Subsidiaries/domestic	264,062	0.4	15.4	14.5
Branches	1,448,124	2.3	84.6	79.7
Residential mortgage lending	4,167,939	6.8	51.9	229.3
Subsidiaries/domestic	1,647,634	2.7	39.5	90.6
Branches	2,520,305	4.1	60.5	138.7
Inter-bank	50,924,287	82.6	82.6	2,801.7
Subsidiaries/domestic	35,574,823	57.7	69.9	1,957.2
of which: intra-group	31,263,082	50.7	87.9	1,720.0
Branches	15,349,464	24.9	30.1	844.5
of which: intra-group	11,310,111	18.3	73.7	622.2
Marketable assets	416,383	0.7	0.7	22.9
Branches	281,307	0.5	67.6	15.5
Subsidiaries/domestic	135,076	0.2	32.4	7.4
Sovereign & PSE lending	216,142	0.4	0.4	11.9
Branches	0	0.0	0.0	0.0
Subsidiaries/domestic	216,142	0.4	100.0	11.9
Other	2,077,154	3.4	3.4	114.3
Branches	1,773,548	2.9	85.4	97.6
Subsidiaries/domestic	303,606	0.5	14.6	16.7
Total liabilities	61,657,453	100.0	100.0	3,392.2
Total deposits	58,132,090	94.3	94.3	3,198.2
Retail	20,129,249	32.6	32.6	1,107.4
Subsidiaries/domestic	14,139,292	22.9	70.2	777.9
Branch	5,989,957	9.7	29.8	329.5
Corporate/trust/fiduciary	27,228,850	44.2	44.2	1,498.0
Subsidiaries/domestic	19,225,234	31.2	70.6	1,057.7
Branch	8,003,616	13.0	29.4	440.3
Inter-bank	10,323,462	16.7	16.7	568.0
Subsidiaries/domestic	2,851,505	4.6	27.6	156.9
of which: intra-group	1,576,127	2.6	55.3	86.7
Branch	7,471,957	12.1	72.4	411.1
of which: intra-group	5,476,481	8.9	73.3	301.3
Other	450,529	0.7	0.7	24.8
Subsidiaries/domestic	388,548	0.6	86.2	21.4
Branch	61,981	0.1	13.8	3.4
Other liabilities	971,923	1.6	1.6	53.5
Capital and reserves	2,553,440	4.1	4.1	140.5

Sources: FSC Quarterly Prudential Returns, Economic Affairs Bank of England Monthly Returns, and staff estimates.

1/ Relative to 2006/2007 GDP of GBP1,817 million.

Table 3. Isle of Man: Structure of Total Deposits, By Region 1/
(end-2008)

	GBP millions	In percent of total	In percent of GDP 2/
Total Deposits	54,642,783	100.0	3006.3
Domestic	17,803,873	32.6	979.5
Cross-border	36,838,910	67.4	2026.7
UK	13,953,045	25.5	767.6
Channel Islands	1,705,578	3.1	93.8
Other (including EU)	21,180,287	38.8	1165.3
Total Deposits	54,642,783	100.0	3006.3
Non-interbank deposits	39,890,948	73.0	2194.7
Domestic	10,725,258	19.6	590.1
Cross-Border	29,165,690	53.4	1604.6
UK	9,848,790	18.0	541.8
Channel Islands	1,213,686	2.2	66.8
Other	18,103,214	33.1	996.0
Interbank (banks and other) 3/	14,751,835	27.0	811.6
Domestic	7,078,615	13.0	389.4
Cross-Border	7,673,219	14.0	422.2
UK	4,104,255	7.5	225.8
Channel Islands	491,892	0.9	27.1
Other	3,077,073	5.6	169.3

Sources: Economic Affairs Bank of England Monthly Returns and staff estimates.

1/ On unconsolidated basis (i.e., excluding overseas branches and subsidiaries of domestically incorporated banks).

2/ Relative to 2006/2007 GDP.

3/ Includes financial institutions other than banks resident in the UK, Channel Islands, and the Isle of Man.

Table 4. Isle of Man: Structure of Total Loans, by Region 1/
(end-2008)

	GBP millions	In percent of total	In percent of GDP 2/
Total Loans	56,527,616	100.0	3109.9
Domestic	8,999,979	15.9	495.1
Cross-border	47,527,637	84.1	2614.8
UK	29,893,003	52.9	1644.6
Channel Islands	5,052,799	8.9	278.0
Other (including EU)	12,581,835	22.3	692.2
Total Loans	56,527,616	100.0	3109.9
Non-intra-bank credit	8,916,681	15.8	490.6
Domestic	3,436,478	6.1	189.1
Cross-Border	5,480,203	9.7	301.5
UK	1,835,098	3.2	101.0
Channel Islands	273,905	0.5	15.1
Other	3,371,199	6.0	185.5
Interbank (banks and other) 3/	47,610,935	84.2	2619.4
Domestic	5,563,501	9.8	306.1
Cross-Border	42,047,434	74.4	2313.3
UK	28,057,904	49.6	1543.6
Channel Islands	4,778,893	8.5	262.9
Other	9,210,636	16.3	506.7

Sources: Economic Affairs Bank of England Monthly Returns and staff estimates.

1/ On unconsolidated basis (i.e., excluding overseas branches and subsidiaries of domestically incorporated banks).

2/ Relative to 2006/2007 GDP.

3/ Includes financial institutions other than banks resident in the UK, Channel Islands, and the Isle of Man.

Table 5. Isle of Man: Insurance Sector Indicators
(In GBP millions unless indicated otherwise)

	2002	2003	2004	2005	2006	2007	2008	Percent of total
Life								
Gross premiums	3,860	3,133	3,975	6,666	9,441	8,427	8,060	85.3
Net premiums	3,314	2,911	3,515	4,125	8,526	8,394	8,004	
Investment income	-1,753	1,703	1,190	2,913	1,889	2,415	-5,167	
Net claims	1,525	1,472	2,186	2,965	3,794	4,959	4,628	
Expenses	196	204	193	239	258	292	308	
ROE (return on equity after tax, percent)	11.84	16.53	41.79	50.16	39.16	18.62	12.21	
Total assets	14,900	18,059	20,578	26,677	33,562	38,634	37,457	87.4
Investments, of which:	14,586	17,635	20,185	26,114	32,864	37,702	36,567	
Government securities	692	670	716	750	1,004	919	1,008	
Corporate securities	587	590	714	587	1,028	640	407	
Equity	6,379	8,082	9,125	12,508	15,283	18,370	17,191	
Deposits	1,547	2,146	2,271	3,596	4,660	5,444	6,033	
Futures and options	0	1	0	0	0	0	0	
Other	5,395	6,238	7,036	6,084	7,544	8,519	8,025	
Real estate and real-estate related	0	0	156	175	200	218	235	
Insurance Debtors	45	35	57	91	126	205	316	
Cash	471	424	804	1,335	1,503	1,481	884	
Liabilities								
Share capital	190	195	180	209	195	199	260	
Share premium	36	6	7	15	15	7	7	
Linked policy liabilities	13,861	16,598	19,169	22,170	28,358	32,869	32,094	
Non-linked policy liabilities	472	518	452	551	484	502	571	
Technical provisions	-17	-1	-30	-32	-74	-127	-42	
Profit reserves	-21	28	40	51	124	138	207	
Required minimum margin 1/	43	51	57	65	82	91	90	
Excess solvency 2/	215	250	252	338	371	377	453	
Coverage ratio (in percent) 3/	400.0	390.2	342.1	420.0	352.4	314.3	405.4	
Captives								
Gross premiums	845	961	969	764	706	833	905	9.6
Net premiums	618	645	698	532	533	605	675	
Investment income	131	192	188	133	170	180	159	
Net claims	486	409	413	387	375	367	483	
Expenses	24	32	53	42	43	50	95	
ROE (return on equity after tax, percent)	8.27	18.40	18.86	15.60	15.82	19.73	11.0	
Total assets	4,632	4,416	3,503	3,804	3,644	3,377	3,725	8.7
Investments	2,645	2,258	2,227	1,969	1,873	3,171	1,280	
Insurance debtors	315	409	260	191	509	347	286	
Cash	554	899	699	763	1,023	1,134	1,290	
Liabilities								
Unearned premiums	505	334	347	299	504	186	235	
Claims (incl IBNR)	1,451	1,589	1,196	1,234	1,633	1,312	1,576	
Other liabilities	221	271	368	232	237	390	126	
Share capital	428	429	531	610	486	512	479	
Share Premium	500	232	290	200	273	273	228	
Profit reserves	1,254	1,396	846	921	1,055	1,036	1,147	
Required minimum margin 1/	47	39	47	38	36	38	35	
Excess solvency 2/	1,573	1,534	1,340	1,384	1,514	1,469	1,580	
Coverage ratio (in percent) 3/	3,246.8	3,833.3	2,751.1	3,542.1	4,105.6	3,765.8	4,378.2	
Total gross premiums	5,153	4,513	5,452	7,800	10,558	9,784	9,448	100.0
Total assets	20,850	23,943	25,630	32,105	38,606	43,654	42,848	100.0

Sources: Insurance and Pensions Authority and staff estimates.

1/ Defined as the mandated minimum stock of net available assets, which are computed as net assets minus reserves.

2/ Defined as the difference between net available assets and the required minimum margin.

3/ Excess solvency to the required minimum margin.

Table 6. Isle of Man: Securities Market Indicators

	2002	2003	2004	2005	2006	2007	June 2008
Collective investment schemes							
Number of licensed investment funds	186	203	253	375	439	464	467
<i>of which:</i>							
Public	135	159	211	311	343	367	367
Private, of which	51	44	42	64	96	97	100
Closed end	0	0	0	26	40	46	52
Open end	186	203	253	349	399	418	415
			(GBP millions)				
Total value of assets under management	4,770	5,040	7,090	14,670	21,390	26,720	28,930
<i>of which:</i>							
Public	4,320	4,500	6,580	13,610	19,320	24,480	26,020
Private	450	540	510	1,060	2,070	2,240	2,910
Closed end	0	0	0	1,810	4,210	5,650	5,990
Open end	4,770	5,040	7,090	12,860	17,180	21,070	22,940
Authorised	850	830	570	610	580	670	610
Full International	1,480	1,500	1,670	2,170	2,450	2,290	2,440
Exempt International	450	540	510	1,060	2,070	2,240	2,910
Experienced Investor	1,820	2,050	3,640	4,450	5,130	5,980	6,050
Professional Investor	170	120	130	130	270	330	70
Overseas	0	0	570	3,370	5,960	9,420	9,890
Closed ended	0	0	0	1,810	4,210	5,650	5,990
Inward Outsourcing	0	0	0	1,070	720	80	70
Specialist	0	0	0	0	0	60	510
Qualifying	0	0	0	0	0	0	180
Legacy Experienced Investor	0	0	0	0	0	0	210
Number of investment business licenceholders and third party	82	88	86	119	88	87	89

Sources: FSC and staff estimates.

9. **The IOM has been able to attract these industries because of certain advantages that it possesses and that have been built upon by active policy (Box 1).** However, shifts in demand for financial services, innovations in financial products, and competition between centers will necessitate the further evolution of the sector.

Box 1. The Evolving Position of the Isle of Man as a Financial Center

The IOM as an international financial center enjoys certain comparative advantages. It is conveniently located to provide services to the London financial market, with which it has a generally similar legal and regulatory structure. The financial system has developed sufficiently that a wide range of quality supporting services (e.g., accountancy and lawyers) are available. The tax system—with zero taxation on most corporate profits (and 10 percent on banks' profits), no capital gains or inheritance tax, and low personal income tax—facilitates tax-efficient asset management, for example, for undertakings involving persons or companies in several tax jurisdictions. Operating costs are reportedly somewhat lower than in other European financial centers, and the authorities have invested in supporting infrastructure. Importantly, the authorities have made clear that their policy is to maintain high and up-to-date standards of regulation and supervision to minimize reputational risk.

Yet, the financial sector will need to adapt as these comparative advantages evolve. Lower-cost centers are likely to attract more routine business, and competition from jurisdictions with the resources to subsidize firms' operating costs may pose a challenge. In this connection, the relative decline in locally-administered retail CIS in favor of those oriented towards institutional investors is likely to continue. The establishment of new captive insurers has slowed significantly. Certain sectors may increasingly tend to become concentrated in a few jurisdictions. Changes in regulations and taxation rules in metropolitan centers, and especially the EU, pose a particular challenge: the IOM offers both the withholding tax and disclosure options under the EU Savings Directive. The 2005 introduction of withholding tax (initially at 15 percent) on interest income for EU residents does not seem to have slowed the inflow of deposits; the next prospective change is the increase in withholding tax to 35 percent in 2011. Slower growth in the financial sector and the UK economy generally could lower the sector's trend growth rate. However, the current global crisis may induce banks to deemphasize wholesale and securitized funding and look more to mobilizing retail deposits, where the IOM's comparative advantage lies.

II. REGULATORY AND SUPERVISORY SYSTEM

10. **The 2003 OFC assessment noted that the jurisdiction had a comprehensive legal framework and supervisory structures that work well in practice, and had strengthened mechanisms for cooperation with foreign supervisors.** The main prudential recommendations related to increasing the independence, accountability and resources of the supervisory agencies, and intensifying on-site supervision. Several specific recommendations were made in relation to individual principles.

11. **Since then, the authorities have taken steps to address many of the issues raised (Appendix I and the accompanying Annex with ROSCs).** However, the financial system has been evolving, and in some cases international standards and methodologies for their assessment have been modified.

A. Institutional Structure

12. **Financial sector regulatory and supervisory agencies comprise the FSC and the IPA.** The FSC is responsible for the regulation and supervision of all financial service providers except insurance companies (and insurance managers and general insurance intermediaries) and pension funds. It is also responsible for the companies' registry. It currently has about 66 staff, about half of which work in the supervision division. The IPA is responsible for the regulation of insurance and pension companies, and associated service providers.

13. **A considerable body of financial sector legislation has been passed since 2002 to keep the legal framework up-to-date and to consolidate provisions.** The new Financial Services Act (FSA 2008) brings together most provisions on the functions and functioning of the FSC. The Insurance Act (IA 2008), which came into force on December 1, 2008, plays a similar role for the IPA. The Collective Investment Schemes Act 2008 streamlines legislation in this area and revises the classification of schemes. It is notable that the supervisory agencies have wide legal powers of intervention and sanction, although a court order is needed for more extreme action (such as the assumption of management) or action involving a non-regulated company or person. The agencies are in the process of updating secondary legislation to be consistent with the recent acts.

14. **A cross-cutting issue is the independence and accountability of the supervisory agencies (Box 2).** Both agencies operate with very considerable independence, and they have taken steps to further enhance accountability. Formally, however, some elements of dependence remains, notably regarding the dismissal of commissioners. The agencies have less budgetary independence than supervisors in many other countries (such as central banks engaged in supervision). The FSC is rightly reviewing the structure of fees on regulated institutions to align them better with the relative costs of supervision.

Box 2. Supervisory Independence and Accountability

Both supervisory agencies operate independently. The agencies and political authorities are publicly committed to maintaining this independence. The recent memorandum of understanding (MOU) between the FSC and the Treasury (as the responsible part of government) emphasizes the FSC's independence; an MOU between the IPA and the Treasury is in preparation. The importance of supervisory independence to the effectiveness of supervision and the IOM's reputation as a financial center is universally recognized. The acknowledged professionalism and expertise of the agencies' management and staff reinforce their freedom of action. While there is extensive consultation with industry groups, the agencies can and do introduce measures despite industry resistance when they judge that their regulatory objectives require it.

Legislative changes since 2002 have strengthened the agencies' formal independence, but some de jure dependence remains. The FSA 2008 and the IA 2008 now have the effect that members of Tynwald are not eligible to be members of either regulator. However, the Tynwald has the right to vote to dismiss the FSC Commissioners for any reason, and the Council of Ministers can dismiss the IPA Board members without having to publish an explanation. Tynwald approval is needed for binding regulations, although in urgent cases this approval can be sought after regulations take effect. The provision allowing the Council of Ministers to "give direction" to the FSC in any matters affecting public interest has been removed. Rather, the Treasury can now "by order specify policies and strategies" to the FSC after consultation. Both agencies remain dependent on the government for their budgets, even though the FSC receives considerable revenue from the companies' registry. The agencies' staffing levels are set annually by the Treasury as part of the budget process, although both agencies have been able to increase staffing as responsibilities have expanded.

The agencies' objectives have been clarified. The FSA 2008 specifies in some detail the objectives of the FSC, which covers client protection, the reduction of financial crime, and "supporting the IOM's economy and its development as a financial center." However, it does not have an explicit mandate to promote the stability of the financial system. Furthermore, there is no clear prioritization of objectives, despite the possibility of conflicts among them at least in the short term; such a multiplicity of supervisory objectives is common internationally. The IPA's mandate is similar to that of the FSC, but it must only "have regard to the desirability of maintaining the competitive position of the island." According to the Treasury-FSC MOU, the Treasury is to set the "Overall Regulatory Strategy," but the MOU makes clear that this policy is much broader than individual regulations or enforcement action. Thus, while the overall objectives of financial sector policy are set by the democratically-elected Tynwald via government, the supervisory agencies have operational independence and "instrument independence" (i.e., they can set its policy instruments autonomously in order to achieve the given objectives).

Accountability mechanisms of both agencies have been enhanced since 2002. The agencies have to explain their actions to the Treasury and Tynwald on a regular basis (as formalized in the MOU). The Treasury has responsibility for checking that regulations are consistent with the legal framework, and for ensuring that operational budgets are properly carried out. Both agencies now publish comprehensive annual reports, which describe their objectives and activities, and include audited financial statements. They both publish additional material for the general public, and maintain websites giving access to regulations and other materials.

B. Banking Sector

15. **The BCP assessment undertaken by the mission confirms the high standard of prudential regulation and supervision found in the 2003 assessment (Annex).** The FSC has continued to strengthen its supervisory practice, for example, by establishing a comprehensive, but risk-based system of on-site visits and meetings with bank management.

Good progress has been made in the implementation of Basel II.⁵ A minimum risk asset ratio (RAR) (the term used for the risk-weighted capital adequacy ratio, CAR) is assigned to each bank; in practice no bank has a minimum RAR below 10 percent. In addition, a trigger ratio for supervisory action is set at least 1 percent above the minimum RAR. However, the development of the banking sector may give rise to new challenges, and in particular the thorough on-site inspection of credit files must remain a priority. On-site visits and off-site monitoring generate a small, but significant number of recommendations from the FSC to banks to improve their compliance with regulations, and sanctions are imposed. The FSC also consults with bank auditors and receives their reports on a timely basis, though supervisory functions are not delegated to auditors. Close cooperation with home supervisors has been established and buttressed by numerous MOUs.

16. The major supervisory challenge for the FSC is how to deal with exposure to parent groups. The main business of banks on the IOM is the collection of deposits and channeling financing to their parents, and therefore they have very large exposures to related parties, and their liquidity is entirely dependent on that of their parents. Exposure to parents is more or less completely exempted from prudential limits, but recent events have demonstrated the large risks that are involved when a systemic crisis prevails. This conundrum has no easy solution. The prudential concerns that arise are mitigated by the FSC's licensing policies, which have admitted mostly subsidiaries or branches of diversified groups from major jurisdictions. Nonetheless, the authorities are appropriately considering how to give more protection to local liquidity and solvency in case a parent group were to come under strain. The FSC could expressly confirm on a regular basis that parents continue to have the will and capacity to support subsidiaries. In addition, the FSC could seek more frequent updates from home supervisors of their assessment of group soundness.

17. Some more complex supervisory issues may become more salient as the financial sector evolves. Provisions for consolidated group supervision are relatively weak. Also, there are no predetermined criteria for judging major acquisition of financial and nonfinancial subsidiaries by banks. At present, the banks incorporated on the IOM do not have major subsidiaries and are largely owned by parent groups, so these issues are not pressing. However, in the future the occasion could arise when changes in group structure, led by a local bank, threaten to impede effective supervision.

18. International standards and best practice are being reviewed in light of the global financial turmoil and the authorities will in due course need to adapt changing standards to local conditions. Some of the global issues are not relevant to the IOM, but in particular measures on anti-cyclicality and liquidity may be applicable.

⁵ Local banks are not implementing the internal ratings-based approach.

C. Insurance Sector

19. **Insurance regulation has been strengthened since the 2003 assessment, as documented by the ICP assessment undertaken by the mission (Annex).** As indicated above, the IPA now has a clear set of objectives and its governance has been changed to reduce the potential for political intervention. The IPA has developed its regulations, including new standards on valuation of life insurance liabilities and new AML/CFT requirements. AML/CFT has also been a focus of much of the IPA's enhanced approach to on-site supervisory work.

20. **Regulation is broadly in line with international standards, taking into account the business carried out on the IOM.** The IPA's approach has been developed with regard to IAIS standards and the international character of the IOM's business. Thus, the IPA has been putting in place MOUs with home regulators and is exchanging information (and attending supervisory colleges and other meetings) extensively. Effective regulation is facilitated by the sound legal and institutional framework, and the availability of actuarial expertise locally and through the IOM's connections to the U.K. profession. The IPA itself chooses to engage a major actuarial consultancy rather than to employ actuaries. These arrangements, and the cooperation between supervisors and actuaries, appear to work well.

21. **There are some gaps in the framework of regulations, but the IPA is working to address most of them.** A significant gap, which was also highlighted in the 2003 assessment, is in standards on corporate governance and related issues (including internal controls, risk assessment and risk management). However, the IPA is close to adopting new binding guidance setting out its expectations in these areas. It already covers governance and related issues in its on-site work (although, in life insurance, so far mainly in relation to AML/CFT controls) and has experience of successfully addressing weaknesses in these areas. Its extensive enforcement powers could also be used for these purposes.

22. **Other gaps include powers and procedures for some aspects of group supervision, for the rare cases where this is necessary, and disclosure requirements.** While the IPA has limited responsibilities at present as a host regulator, it needs to ensure that it can carry out effective group supervision for existing and potentially future insurance companies that are based on the IOM. The IPA also recognizes that, while information on the financial position of many IOM insurance companies is available (e.g., from parent groups), companies are not formally required to publish any such information. It is working with the industry on possible new disclosure requirements, taking account of IAIS disclosure standards.

23. **The IPA is conscious of the need to maintain a flexible and responsive approach, including on resources, to meet future developments in insurance business and its regulation.** The IPA's resources are small in number (just 12 staff in total to cover insurance and pensions, although bolstered by access to actuarial consultants and cooperatively

working with the local actuarial society). But it has recruited skilled individuals to assist in the development of its on-site work in particular. The IPA faces challenges in developing a response to the EU Solvency II initiative, which, while not binding on it, will affect most parent groups and set a new international standard. The IPA's current resources could be stretched also by the development of major new lines of insurance business (there is interest in attracting reinsurance).

D. Collective Investment Schemes

24. **The general approach to CIS regulation is to ensure the protection of more at-risk investors and the reputation of institutions operating on the IOM, while limiting the regulatory burden.** To this end, the acknowledgement of regulation and supervision by well-regarded overseas authorities offers a form of “leverage” of the authorities’ efforts. For example, companies and funds listed on overseas exchanges will have stringent requirements on their prospectuses and reporting imposed by those exchanges, so there is assumed to be little need for extensive additional requirements.

25. **The major recent change in the regulatory framework for CIS is the reorganization of CIS classes.** CIS belonging to classes oriented toward small-value retail investors are most tightly regulated and supervised; the more a CIS is oriented toward sophisticated and institutional investors, the lighter the regulation in such areas as portfolio composition, disclosure, and reporting, but there are mechanisms to ensure that investors are aware of the risks involved and to prevent regulatory arbitrage.⁶ This approach has remained unchanged, but categories have been adjusted and streamlined; there are still some CIS “grandfathered” under the old classification scheme.⁷ However, the regulation of CIS managers and administrators does not differentiate by type of fund.

26. **The IOM has become a signatory to the IOSCO Multilateral MOU, which the FSC can implement using the full range of its powers because it qualifies under the FSA 2008 as a mutual assistance agreement.** In this connection, the FSA 2008 strengthened the FSC's powers to investigate insider dealing and market manipulation, on its own behalf or on behalf of overseas authorities.

27. **The authorities are aware that their reliance on overseas regulators requires that they keep up with regulatory changes abroad.** The authorities will also need to

⁶ For example, for some classes of CIS the scheme manager, the client, and the client's financial advisor all need to certify that they are aware of the terms and conditions that apply.

⁷ According to the current classification, “authorized” schemes are CIS designed for retail investors. “Full international” CIS are eligible for listing on certain exchanges overseas and are also suited to retail investors. The new “specialist” and “qualifying” classifications are for CIS with features to suit them to large or institutional investors. “Overseas” CIS are not domiciled in the IOM but are administered on the island.

remain vigilant for signs of regulatory arbitrage and abuse of the system, such as the marketing of lightly regulated CISs to unsuitable clients, which would be harmful to the IOM's reputation even if no legal or moral responsibility is involved. Clients' complaints (here and in life insurance) are likely to multiply when market conditions deteriorate, in part because misunderstood practices may become more contentious when returns are negative.

E. Company and Trust Service Providers

28. **CSPs and TSPs do not present a major source of financial stability risk.** CSPs and TSPs only manage client assets, and economic losses in this sector would not threaten the financial soundness of the Manx system. However, the sector brings reputation and AML/CFT-related risks, which the FSC regulates closely. From a supervisory perspective, the FSC focuses mainly on ensuring that directors and trustees fulfill their corporate governance responsibilities.

29. **The Fiduciary Services Act 2005 set the framework for the regulation and supervision of TSPs.** Related regulations, including "fit and proper" rules, are now in place, and enforced through reporting requirements and on-site visits. Many CSPs have acquired TSP licenses. Money transmission services now fall within the scope of regulation under the Regulated Activities Order 2008, which came into effect on August 1, 2008.

30. **Owing to recent hirings, supervisory resources for this sector appear adequate.** In 2007, fiduciary service providers accounted for 65 percent of all focused supervisory visits. Currently, 10 staff are responsible for licensing and supervising the 195 license holders and conducting on-site visits to them on a three-year rolling basis. However, in the future, the FSC could face again a trade-off between allocated additional resources to a more systemic sector, such as banking, rather than to a more labor-intensive sector, such as this one.

F. AML/CFT Provisions and Implementation

31. **The IOM's AML/CFT legal framework is broadly in line with the FATF Recommendations (Annex), having been upgraded significantly in the second half of 2008.** Remaining deficiencies are mostly technical in nature and implementation is generally effective.

32. **Money laundering (ML) is criminalized broadly in line with the international standard and most technical aspects of the Vienna and Palermo Conventions are complied with.** All categories of predicate offenses listed in the international standard are covered. While the statutory sanctions for ML-related offenses are, in a formal sense, comprehensive, dissuasive, and proportionate, the sentences actually imposed by the courts appear rather low. The legal framework for seizure and confiscation is generally comprehensive. With regard to combating the financing of terrorism, the implementation of the relevant United Nations (UN) resolutions and EU Regulations follows that of the UK.

33. **The FCU, in acting as the FIU, performs its role adequately.** It receives a reasonable flow of suspicious transaction reports (STRs), mainly from financial institutions. Within the FCU, there is a clear separation between the intelligence and the investigative sides. However, the low number of cases in which STRs result in investigations or in prosecution raises an effectiveness issue that needs to be addressed. Additional resources are being provided to the FCU.

34. **The IOM has brought its AML/CFT preventive measures largely into compliance with the FATF Recommendations and has formally adopted a risk-based approach.** License-holders are required to conduct a risk assessment of their businesses and apply enhanced customer due diligence (CDD) required where higher risks are identified. The recently-enhanced requirements include those relating to conducting business with politically exposed persons (PEPs), and the controls over reliance which may be placed by the IOM financial sector on business introducers to conduct certain CDD measures. However, some available concessions go beyond a reasonable interpretation of the FATF Recommendations.

35. **The IOM's financial institutions are generally well supervised for AML/CFT purposes.** The authorities plan additional AML/CFT on-site inspections, particularly for the banking and insurance sectors. CDD obligations for designated nonfinancial businesses and professionals (DNFBPs) largely mirror those for financial institutions. CSPs and TSPs are regulated and closely supervised by the FSC. The on-line gaming sector, while small, is subject to inherent challenges in relation to CDD. The company registration system is well developed.

36. **The IOM authorities actively engage in international cooperation in this area.** The range of available mutual legal assistance (MLA) is broad; requests are frequent and dealt with efficiently. Domestic coordination and cooperation is well developed, particularly through the initiatives of the Joint AML Advisory Group.

III. STABILITY ISSUES

A. Risk to the Financial System

37. **Linkages to parent banks are a source of strength, but also create vulnerabilities, as seen recently.** The close linkage of domestically incorporated banks to financially sound and well-managed parent banks, which could support their affiliates if need be, normally underpins the resilience of the Manx banking system. Furthermore, Manx operations account for a non-negligible share of net group funding, which further raises the likelihood of

parental support in the case of stress, particularly if the shock originates in the IOM.⁸ Nonetheless, these linkages also present important concentration risk, which create vulnerabilities to financial problems at the group level. Thus, the problems of parent banks during the current global financial crisis has affected their Manx subsidiaries.

38. **Another potential vulnerability relates to reputation risk if investors lose confidence in the soundness of Manx financial institutions.** This could occur, for example, if investors withdraw their deposits owing to financial stress in another part of the financial system or parent bank. In addition, reputational risk could be realized if some event occurred on the IOM that affected its attractiveness relative to other financial centers. Such reputational risk extends beyond the banking system to the insurance and CIS sectors. The latter in particular is large and diverse, and recent scandals elsewhere are reminders of the possibility that agents will engage in dubious practices.

39. **Other risk factors are less important for systemic soundness.** Banks' loan exposure to the nonbank sector is small relative to their balance sheet. A significant share of the loan portfolio is collateralized or guaranteed by the parent institution, reducing the role of credit risk. Less than half of banks' non-interbank loans are channeled through the local economy (6 percent of total claims), but this exposure remains substantive relative to GDP (estimated at twice 2007 GDP). Financial institutions do not take large market positions or engage in very complex operations (which are handled by their parents), so exposure to market risk and certain operational risks should be small.

B. Performance and Stability Indicators

40. **Recent global financial turmoil has severely affected the parent groups of banks on the IOM in the last quarter of 2008, until when the direct effect of the turmoil on banks (and other financial institutions) had been slight.** Local banks have no significant exposure to the most affected asset classes, and the largely retail nature of their deposit base ensured that they were not affected by disruption in the interbank and securities markets. However, several of the UK and other EU banks and building societies that have local subsidiaries or branches have received various forms of assistance and in some cases have merged. At the very least, local banks will reduce staffing. More dramatically, difficulties encountered by one parent of a local bank led to the suspension of the latter's license; it is now in liquidation. The FSC had already ensured that the local bank had transferred its assets from the head office to a UK subsidiary, but since that action was taken the UK subsidiary has been placed in administration. The payout to insured depositors is expected to be

⁸ Except for the affiliates of the very large global groups, domestically incorporated banks provided between 3 and 25 percent of their groups' customer funding (11 percent on unweighted average) and between 1 percent and 15 percent of total group funding (6 percent on unweighted average).

completed shortly; substantial government support to the DCS has been provided, although the final net cost is hard to estimate pending the resolution of the UK affiliate.

41. **Profitability and capitalization has been very comfortable given low risk-weighted assets, but leverage has traditionally been relatively high (Table 7).** The high risk-weighted CAR reflects the high share of intra-group loans that attract a low risk weight.⁹ The main underlying cause is the tax efficiency of booking profits and “warehousing” capital in the IOM. The average quality of assets is driven largely by the relatively low share of non-intrabank loans (16 percent of total claims), many of which are collateralized, and the normally low risk on intra-group loans. Nonperforming loans are minor and adequately provisioned. Banks’ main source of earnings is net interest income, which is derived from the transfer of customer deposits to their parent banks. Since the parents are mostly large diversified groups, income is steady and depends largely on transfer pricing.¹⁰

42. **The banking sector as a whole usually exhibits ample liquidity given that claims on groups are mostly very short term.** In some cases, banks’ assets are of shorter maturity than their liabilities. Standard liquidity indicators were falling through mid-2008, but strengthened at end-2008.

43. **Likewise the insurance sector has been highly profitable relative to its low risk profile, and is particularly well-capitalized (See Table 5).** Life insurance companies, which account for 80 percent of gross premium income, have achieved especially high returns in the wake of sharp increases in business. Solvency has remained comfortable: net assets available to meet the required minimum margin (RMM) exceed the RMM by five times over.¹¹ The captive sector is even more strongly capitalized in aggregate. Many overseas insurance groups with operations in the IOM as well as parents of the captive companies choose to accumulate surpluses in the IOM company against future business growth or for tax management purposes.

⁹ In 2008, the IOM’s risk-weighted CAR was 14.8 percent, compared for example to 12.9 percent in the UK, 10.6 percent in Ireland, and 16.1 percent in Luxembourg (source: *Global Financial Stability Report*). The unweighted capital to asset ratios for these other countries were 4.4, 4.1 and 5.2 percent, respectively, while that of the IOM banks was 4.8 percent, up from 3.3 percent the year before.

¹⁰ However, tax regulations tightly limit the ability of parents to shift profits to low-tax jurisdictions.

¹¹ Net available assets is approximately equal to assets minus reserves. The RMM for a company is the mandated minimum stock of net available assets.

Table 7. Isle of Man: Financial Soundness Indicators for the Banking Sector 1/
(in percent)

	2004	2005	2006	2007	2008
Capital adequacy					
Regulatory capital / risk-weighted assets 2/	19.2	15.8	17.2	14.3	14.8
Regulatory Tier I capital / risk-weighted assets 2/	18.1	16.0	15.6	15.2	15.0
Capital / total assets 2/	3.5	3.0	3.3	3.3	4.8
Asset composition 3/					
Sectoral loan distribution / total loans					
Nonbank financial institutions	2.4	2.3	1.9	2.7	3.4
Nonfinancial corporations	2.4	2.1	2.5	2.9	3.0
Households	6.1	6.1	5.9	6.5	6.0
Public sector	0.6	0.4	0.4	0.4	0.4
Nonresidents	10.7	9.8	9.9	15.0	21.7
<i>of which</i> : Banks	54.1	63.6	64.7	63.1	73.1
Other sectors (e.g., mostly interbank)	77.7	79.4	79.3	72.5	65.6
Geographical loan distribution / total loans					
Domestic	17.9	14.3	14.7	15.1	14.5
Cross-border	82.1	85.7	85.3	84.9	85.5
<i>of which</i> : UK	66.7	71.8	74.2	69.7	63.6
<i>of which</i> : Channel Islands	14.0	14.6	12.0	10.8	11.1
<i>of which</i> : Other (including EU)	19.3	13.6	13.8	19.5	25.3
Asset quality					
Nonperforming loans / non-interbank loans	...	...	1.2	0.5	1.5
Loan loss provisions / non-interbank loans	...	...	0.1	0.2	0.3
Loan-loss provisions / nonperforming loans	...	...	32.3	30.7	20.7
NPLs net of loan-loss provisions / Tier 1 capital	...	...	1.5	1.9	6.1
Large exposures / capital 4/	...	...	59.7	47.7	50.2
Earnings and profitability					
Return on assets	0.7	0.7	0.6	0.7	0.6
Return on equity	15.4	18.5	15.6	16.1	17.2
Net interest margin 5/	...	...	0.8	0.8	0.8
Gross income / average assets	...	...	1.0	1.0	1.0
Net interest income / gross income	...	...	74.6	75.4	79.8
Noninterest expenses / gross income	...	...	38.5	34.7	39.1
Liquidity					
Liquid assets / total assets	78.7	82.6	71.6	67.5	73.9
Liquid assets / short-term liabilities	102.1	104.1	87.2	83.5	115.9
Non-interbank loans / total deposits	14.8	13.7	15.5	16.1	16.1
Sensitivity to market risk					
Off-balance sheet operations / total assets	...	...	3.0	3.2	2.5
Interest rate contracts	...	...	2.7	2.5	1.7
Forex contracts	...	...	0.2	0.5	0.6
Other derivatives	...	...	0.1	0.1	0.2
Derivative contracts / total assets					
Contracts held other than trading (notional amount)	6.9	2.5	3.0	3.2	2.5
Contracts held other than trading (market value)	0.1	0.1	0.2	0.1	0.0
Potential credit exposure	0.3	0.1	0.0	0.0	0.0
Other / total assets					
Guarantees 6/	2.2	2.0	2.1	1.9	1.7
Commitments 7/	2.0	0.9	1.4	1.6	3.6
Other credit substitutes	0.3	0.2	0.2	0.4	0.2
Net open position in foreign exchange to capital 2/	0.6	0.5	0.5	0.7	0.1

Sources: FSC and staff estimates.

1/ On consolidated basis, unless specified otherwise.

2/ Excluding domestically incorporated branches and overseas branches.

3/ On unconsolidated basis (i.e., excluding overseas branches and subsidiaries).

4/ Excluding claims on parent banks.

5/ Net interest income / interest bearing assets

6/ Relative to captive insurance companies provided by large parent banks.

7/ Relative to a range of product lines for funds, etc.

44. **In connection with the discussion of FSIs (and stress testing), it is worth noting that the supervisory agencies have a great deal of data on financial institutions, more of which could be compiled and analyzed for the system as a whole on a regular basis.** A better statistical base would be useful for the authorities in tracking overall developments and conducting peer group analysis, and for outside observers and potential investors. It may be feasible to integrate information from prudential returns (taking care to preserve confidentiality) and other sources that are currently used, for example, to provide statistics to international organizations. Furthermore, it would be useful to collect more and more timely information on the balance sheets of the household and local corporate sectors, which may have large assets and liabilities abroad; their financial position may be of limited importance to the stability of the banking system, but matters for overall policy purposes (Table 8).¹²

Table 8. Isle of Man: Financial Soundness Indicators for the Nonbanking Sectors
(in percent)

	2002	2003	2004	2005	2006	2007	March 2008
Corporate sector							
Total debt / GDP	94.4	82.9	92.6	70.7	110.8	103.5	122.0
Household Sector							
Total debt / GDP	-	-	-	-	104.4	99.3	98.8
Debt service burden / disposable income	-	-	18.6	19.9	20.5	19.4	19.3
Real estate sector							
House price inflation	10.5	15.3	12.5	9.7	4.3	3.9	12.0

Source: Isle of Man authorities.

C. Stress Test Results

45. **Stress tests were performed to assess the resilience of banks and insurance companies to a variety of shocks.** The methodologies and shocks were chosen in consultation between the FSC, IPA, and the FSAP team (Appendix II). The shocks were based on historical stress scenarios, periods of heightened volatility, and historical distributions of key macro variables for peer economies. Estimation was performed both “top down” by the authorities with the FSAP team, and “bottom up” by individual commercial institutions.

Banking

46. **The main potential areas of concern relate to concentration risk and spillovers from parent banks, which, however, are difficult to capture quantitatively. If,**

¹² No data are available on households’ and corporates’ borrowing abroad (e.g., in the form of credit card debt) and through nonregulated retail financing houses.

hypothetically, banks had to provision for claims on parents, 10 percent provisioning of their claims on the parent, for example, would wipe-out the capital base of the Manx banking sector. Moreover, major shocks to parent banks are likely to be correlated with a general economic downturn, which would affect the loan portfolio. However, the impact of a major problem in a parent bank with a Manx affiliate would be highly nonlinear, with limited impact on the affiliates in the case of mild stress and disastrous consequences in the event of extreme stress. For example, the resilience of Manx affiliates to liquidity strains hinges upon parent banks' ability to provide adequate day-to-day liquidity and other financial guarantees when needed. This, however, may be particularly difficult if the cause of the deposit drain is related to the parent bank's solvency or liquidity.

47. **Stress tests confirmed that the Manx banking system exhibits considerable resilience against other large shocks (Table 9).**¹³ Credit risk is not a dominant risk factor, as shown in test C1, where all banks reported a less than one percentage point change in their CAR. These results reflect banks' relatively small (non-interbank) loan portfolio and partly the way in which the shocks were calibrated. Where available, banks were asked to double their probability of default or shock their three largest (non-intra-group) exposures, all of which started from very low levels; owing to limited data availability, the FSC assumed a 1 percent default on the banks' total (non-intragroup) loan portfolio. For sensitivity analysis purposes, stronger but more concentrated shocks were conducted on particular credit sub-categories. Although the results were more substantive, they confirmed banks' overall resilience to credit risk. For example, a macroeconomic shock that leads to a 10 percent default on banks' mortgage loan portfolio (many of which relate to properties off the IOM) would reduce the aggregate CAR by 124 basis points but leave it comfortably above the minimum. At most one small bank would be severely affected under this scenario and require support from its foreign parent.

48. **Market risk is similarly moderate, due to only small active position-taking and various group transfer pricing and other maturity and currency matching arrangements.**¹⁴ The banking system exhibits ample liquidity buffers to absorb a dramatic deposit drain. A number of banks would have difficulty meeting a rapid withdrawal of almost all short-term deposits under the strong assumption that parent banks do not provide support—so again the vulnerability relates to exposure to parents. The effects of shocks to securities market were negligible.

¹³ The Manx motto is "Quocunque jerceris stabit," which can be loosely translated as "It is stable no matter what the shock."

¹⁴ For most banks, an interest rate shock is likely to affect mainly the flow of net income on the banking book rather than create revaluation effects on the (minimal) trading book.

Table 9. Isle of Man: Stress Test Results for the Banks

Shocks	Bottom-Up						Top-Down					
	Average	Min.	Max.	Income	Min.	Max.	Average	Min.	Max.	Income	Min.	Max.
	1/ Loss/Gain						1/ Loss/Gain					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Percentage point change			In percent of pre-shock capital			Percentage point change			In percent of pre-shock capital		
Pre-shock capital	14.44	11.72	34.64	-	-	-	14.44	11.72	34.64	-	-	-
Interest Rate Risk												
I1: Parallel upward shift of the sterling yield curve by 200 basis points.	-0.09	-0.73	0.01	-0.53	-2.09	2.09	0.87	-1.63	1.62	6.05	-12.95	13.27
I2: Parallel downward shift of the sterling yield curve by 200 basis points.	0.02	-0.32	0.72	0.53	-2.15	2.07	-0.87	-1.62	1.63	-6.05	-13.27	12.95
I3: Parallel upward shift of the dollar yield curve by 200 basis points.	-0.02	-0.20	0.06	-0.07	-1.14	0.50	0.04	0.00	0.10	0.28	0.00	0.78
I4: Parallel downward shift of the dollar yield curve by 200 basis points.	0.00	-0.06	0.08	0.07	-0.50	1.14	-0.04	-0.10	0.00	-0.28	-0.78	0.00
I5: Parallel upward shift of the euro yield curve by 200 basis points.	-0.02	-0.18	0.04	-0.08	-0.98	0.37	0.07	-0.01	0.13	0.50	-0.06	1.05
I6: Parallel downward shift of the euro yield curve by 200 basis points.	0.00	-0.04	0.06	0.08	-0.37	0.98	-0.07	-0.13	0.01	-0.50	-1.05	0.06
FX Risk												
F1: The pound depreciates by 20 percent against all other currencies. 2/	-0.04	-1.06	0.01	0.01	-0.07	0.01	-0.02	-0.19	0.00	0.11	0.00	0.98
F2: The pound appreciates by 20 percent against all other currencies.2/	0.03	-0.01	0.84	-0.01	-1.10	0.00	0.03	0.00	0.19	-0.11	-0.98	0.00
F3: The dollar depreciates by 20 percent against all other currencies.2/	0.02	-0.01	0.48	0.00	-0.15	0.00	-0.01	-0.04	0.18	-0.06	-0.91	0.36
F4: The dollar appreciates by 20 percent against all other currencies. 2/	-0.02	-0.64	0.01	0.00	-0.06	0.00	-0.02	-0.18	0.04	0.06	-0.36	0.91
Credit Risk												
C1: Doubling of all probabilities of default (PDs) on loans. 4/	0.03	-0.33	0.10	-0.66	-11.81	0.00	-0.78	-9.38	0.00	-5.80	-75.76	0.00
A1: If 10% of domestic nonbank loan fail 5/	-	-	-	-	-	-	-1.42	-8.26	0.00	-10.53	-44.78	0.00
A2: If 10% of mortgage loans fail 5/	-	-	-	-	-	-	-1.24	-21.63	0.00	-9.21	-164.52	0.00
A3: If 10% of UK nonbank loans fail 5/	-	-	-	-	-	-	-0.34	-5.30	0.00	-2.54	-37.13	0.00
A4: If 10% of parent bank fails 5/ 6/	-	-	-	-	-	-	-10.58	-	-	-73.97	-	-

Sources: FSC and staff estimates.

1/ Unweighted average across the twelve banks.

2/ Modeling spot risk (i.e., impact on net assets, RWA, and income).

3/ Modeling translation risk (i.e., shock absorbed fully by asset valuation effect)

4/ If PDs are not available, default of the largest three exposures excluding the parent bank.

5/ Assuming a 50 percent recovery rate, in line with regulatory risk weights applied to assets.

6/ Based on aggregated data, including branches.

Insurance

49. **Stress tests confirm that the Manx life insurance sector exhibits considerable resilience against shocks (Table 10).** The results principally reflect the sector's limited exposure to risk: most business is unit-linked, and therefore display many of the features of a mutual fund. Hence, key risks are either low (in the case of mortality risk) or borne by policyholders (market risk). The effects of shocks to mortality risk are therefore negligible and insurers have limited credit and property risk.

50. **Other market risk shocks have a more significant impact, especially where they involve changes to the fund values.** Insurance companies must hold reserves equal to the difference between future expenses and expected future charges, most of which are linked to funds under management. The present value of future expenses is sensitive to movements in interest rates (higher rates lead to higher discounting of future expenses), while future charges are sensitive to changes in fund values and hence all market movements. Hence, stresses that reduce fund values have a significant impact on solvency. But the results show that, on average, minimum requirements are still comfortably covered in all the tests. In practice the IPA expects firms to meet a margin of at least twice the formal minimum, but this level is also well-covered after the shocks. While results may vary by company, it appears that in aggregate the existing solvency approach in the IOM for unit-linked business is typically more prudent than the one expected on the Solvency II basis.

Table 10. Isle of Man: Stress Test Results for the Life-Insurance Sector

	Coverage Ratio 1/	Average 2/	Min.	Max.
	(1)	(2)	(3)	(4)
	In percent	Percentage point change		
Pre-shock coverage ratio	421.54			
Interest Rate Risk				
I1: 200 bp parallel upward shift of the sterling yield curve.	466.23	44.70	0.00	191.33
I2: 200 bp parallel downward shift of the sterling yield curve.	338.06	-83.47	-353.35	0.50
FX Risk				
F1: 20% pound appreciation against all other currencies.2/	425.44	3.91	-156.89	140.31
F2: 20% pound depreciation against all other currencies. 2/	411.75	-9.79	-155.55	95.06
Asset Price Risk				
A1: 35% price decline of shares on foreign stock markets.	488.26	66.72	-50.88	1028.87
A2: Rated securities are downgraded by two categories.	421.50	-0.04	-18.60	12.32
A3: 20% price decline in residential and commercial real estate.	424.18	2.64	-5.62	12.32
Insurance Risk				
M1: Permanent 25 % increase in mortality rates of insured lives.	399.96	-21.58	-82.83	3.85
M2: Permanent 25 % increase in morbidity rates.	421.54	0.00	0.00	0.00
M3: Permanent 25 % in annuitant mortality rates.	418.46	-3.07	-17.18	0.00

Sources: IPA and staff estimates.

1/ Net admissible assets to required minimum margin (coverage ratio is 100 if admissible asset equal minimal margin).

2/ Unweighted average across the eight life-insurance.

D. Intervention and Contingency Planning

Intervention powers, resolution procedures, and safety nets

51. **The authorities have broadly adequate powers to direct and ultimately intervene in a troubled financial institution, although there is no special legal framework for the resolution of financial institutions.** While there is no automaticity in intervention, banks are aware that they will be requested to take remedial action if their CAR falls to within one percentage point of the required minimum. Experience elsewhere suggests that it is useful to have a dedicated bank insolvency regime. For example, it may be helpful to have special provisions for “purchase and assumption,” so that bank deposits and matching assets can be quickly transferred to a healthy bank.

52. **The coverage of the IOM’s DCS is unusually extensive for a small, internationally-oriented jurisdiction, and relative to the domestic economy (Table 11).** After recent amendments, bank deposits are 100 percent insured up to GBP50,000 per individual depositor and GBP20,000 for other depositors. Investors in authorized (i.e., retail) CISs and life insurance policyholders are protected by separate schemes. All schemes cover residents and nonresidents investing or depositing through the IOM offices of locally incorporated institutions, and depositors in IOM branches of institutions from abroad. In case of need, the DCS would be funded ex post by the remaining banking institutions that are members of the scheme. However, already the recent pay-outs to depositors in a relatively small bank required a substantial contribution from the government.

53. **The authorities’ recent changes to the DCS have brought the system more into line with those now prevalent in the EU, but further refinement may be needed.** The current DCS displays most of the desirable characteristics of deposit insurance (such as quick payouts). Nonetheless, when the current severe strains in global financial markets have eased, the authorities should reexamine the DCS to ensure that contingent liabilities are in line with the resources that are effectively available. The DCS is, legally, a contingent liability of the banks themselves, which pay premia, but in the event of a large pay-out they may be reluctant to pay for compensation to the depositors of a failed competitor; they have the option to relocate. The government might assume liability for any large pay-out, but fiscal resources are small relative to the financial system. One approach would be to limit deposit insurance coverage to truly local deposits, which approach would contain the contingent liability, facilitate the achievement of adequate pre-funding, and ensure that social objectives are met. In this connection, depositors need to be made aware in advance of the main features of the scheme; otherwise uncertainty in this area may undermine depositors’ confidence.

Table 11. Isle of Man: Depositors Compensation Scheme 1/
(end-September 2008)

	Domestic Banks 2/	Foreign-Owned Subsidiaries 3/	Foreign-Owned Branches 4/	Total
	(Number of depositors)			
Depositors covered	950	418,605	224,090	642,695
Depositors with deposits GBP20,000 and below	348	277,991	164,920	442,811
Depositors with deposits over GBP20,000	602	140,614	59,170	199,784
	(In GBP thousands)			
Covered deposits	59,793	36,220,918	10,062,915	46,283,833
Deposits GBP20,000 and below	2,542	...	...	...
Deposits over GBP20,000	57,251	...	...	...
Effective liabilities 5/	33.730	11.383.120	5.438.175	16.821.295

Source: Financial Services Commission.

1/ 31 out of the 41 licensed banks participate in the depositor compensation scheme.

2/ Wholly-owned Manx bank (i.e., overseas branches or subsidiaries).

3/ Domestically incorporated bank with foreign ownership.

4/ Branches in IoM of banks incorporated overseas.

5/ Computed as the sum of 100 percent of net deposits (i.e., total deposits net of offsetting loans) of GBP20,000 and below for non-individuals, plus GBP 20,000 for each non-individual depositor with net deposits over GBP20,000, plus 100 per cent of net deposits of GBP50,000 and below for individual depositors, plus GBP 50,000 for each individual depositor with net deposits over GBP 50,000.

Contingency planning

54. **The authorities have rightly recognized the need to plan for contingencies in the financial sector, and preparations have begun.** The starting point for any contingency planning should be a clear understanding of objectives, constraints, and risk factors. In this regard, the authorities may wish to enhance their stress testing capacity in order to calibrate possible stress scenarios. Some of the considerations that should go into the design of contingency plans and associated stress tests include:

- (i) The large financial exposure of local institutions to their parent institutions, and their operational dependence on them;
- (ii) The absence of a lender of last resort (LOLR) facility or other mechanism to provide banks with liquidity, given the monetary union with the UK. Fiscal resources are relatively small;
- (iii) The high probability that, in a crisis situation, home supervisors will devote low priority to timely cooperation with the Manx authorities and minimizing costs to the IOM;
- (iv) The limited ability of the authorities to track developments overseas in real time, for example, because they cannot monitor the payments system; and
- (v) The dependence of most banks' business models on the attractiveness of the IOM as a low-cost, low-risk location through which to channel resources to their parent institutions and, to a much more limited extent, other investments.

55. **The FSC is rightly taking the lead in contingency planning, but other agencies will have to be involved.** In particular, the Treasury will have responsibility for the possible mobilization of resources; the FSC-Treasury MOU provides a framework. Equally important, the authorities will need to strengthen in advance arrangements for cooperation and communication with the home supervisors of institutions represented on the IOM. Consideration could be given to developing arrangements that parallel or are linked to those envisaged under the EU's June 2008 MOU on financial crisis management (e.g., on early notification of strains and possible participation in relevant cross-border stability groups).

ANNEX—OBSERVANCE OF FINANCIAL SUPERVISION STANDARDS AND CODES— SUMMARY ASSESSMENTS

This Annex contains the summary assessments of standards and codes in the financial sector. The assessment has helped to identify the extent to which the supervisory and regulatory framework is adequate to address the potential risks and vulnerabilities in the financial system.

The following detailed assessments were undertaken:

- Basel Core Principles for Effective Banking Supervision—by Mr. Kruschel (BaFin) and Mr. MacDonald (consultant).
- The IAIS Insurance Core Principles—by Mr. Tower (IMF/MCM).
- The FATF 40+9 Recommendations for AML/CFT—by Mr. Donovan (IMF/LEG), Mr. Clemmer, Ms. Dunker, Ms. Kelaart-Courtney, and Mr. Verhelst (consultants), and approved by Mr. Hagan.

The IOM's compliance with the international supervisory standards is generally high, and most of the issues raised in the 2003 assessment have been addressed.

A. Basel Core Principles for Effective Banking Supervision

56. **The regulatory system and prudential supervisory practice have been improved, building on the high standard found in the 2003 assessment.** Laws and regulations are kept up-to-date. The FSC has continued to strengthen its supervisory practice, for example, by establishing a comprehensive, risk-based system of on-site visits. Good progress has been made in the implementation of Basel II. Cooperation with home supervisors has been enhanced and buttressed by numerous MOUs. The FSC's operational autonomy has been reinforced. The major supervisory challenge is how to deal with exposure to parent groups.

Introduction

57. **This assessment of implementation of the BCPs was undertaken as part of an IMF FSAP Update for the IOM in 2008, and in particular was prepared during an IMF mission that visited the IOM during September 2008.** This assessment follows-up on an earlier BCP assessment performed in the context of the 2002/2003 IMF OFC assessment of the IOM.

Information and methodology used for assessment

58. **The assessment of compliance with the BCPs was made on the basis of a study of the legal and regulatory framework, and detailed discussions with relevant authorities and stakeholders.** The assessment was conducted in accordance with the Basel Committee's

revised Core Principles Methodology (October 2006). The assessment team is grateful for the very good cooperation received from the IOM authorities. This included the comprehensive provision of documentation and extensive supplementary information, and the FSC's self-assessment of compliance with the BCPs.

Institutional and macroeconomic setting and market structure—overview

59. **The IOM is a self-governing Crown Dependency.** However, it is in a monetary and customs union with the UK. The authorities have followed a strategy based on sound public finances, creation of a stable and efficient tax environment (“tax neutrality”), and the maintenance of the island’s reputation as a safe and reliable jurisdiction for locating business. This last element has been particularly important for the development of banking and other financial activities.

60. **The FSC is the sole supervisory authority for banks operating on the IOM.** It operates within a supportive legal framework and is empowered, subject to approval by parliament (Tynwald), to issue legally binding regulations for banks’ operations. The banking law was recently revised. Consequently, the legal basis for banking regulation is now located in the FSA 2008. In general, the FSA 2008 made few substantive changes to the FSC’s legal powers, which it has used effectively to issue comprehensive and effective bank regulations. These were contained in the Banking (General Practice) Regulatory Code 2005 (the Code) at the time of the assessment. However, at the beginning of 2009 they will be replaced by new requirements contained in the Financial Services Rule Book 2008 (the Rule Book) which the FSC has already issued under the FSA 2008.¹⁵ At the time of the assessment the FSC was revising its guidance for banks to take account of the revised provisions in the Rule Book.

61. **Macroeconomic developments have been generally favorable for the development of the banking system.** Annual GDP growth has averaged over 8 percent over the last 10 years. Unemployment is negligible. Inflation has been moderate.

62. **Banking continues to be the largest component of the financial sector, generating almost one fifth of the island’s GDP.** Since 2003, banks’ total assets more than doubled from GBP 33.5 to GBP 68.1 billion. With the exception of two Manx banks, all banks are branches and subsidiaries from EU countries (mainly the UK and Ireland) and some other countries.

¹⁵ The entire Rule Book came into force on August 1, 2008, for new licenses granted after that date. For existing license-holders the entire Rule Book is not applicable until January 1, 2009, apart from the AML part, which came into force on August 1, 2008, for all license-holders.

63. **Banks' business models are diverse.** However, one major element of most models is the collection of retail deposits from overseas (for example, from UK nationals working in third countries, and from non-EU nationals resident in the UK but not domiciled there) or from institutions such as trust services providers, which place clients' funds with banks on the island. As a consequence, intra-group claims account for over 70 percent of customer deposits. Besides placements with parents, there is limited lending to the local economy, some lending to entities incorporated on the island with business elsewhere, and residential mortgages in the UK. Banks do not operate trading books and in almost all cases liquidity is managed by parent banks.

64. **The recent global financial markets turmoil has had a significant impact on the Manx financial system.**¹⁶ At the time of the assessment, the impact was still small. However, since September 2008 a number of UK banks with operations on the island have undergone various forms of intervention, and the local subsidiary of a non-EU bank has had its license suspended and possibly will be wound up. The full implications of these events will take time to be determined.

Preconditions for effective banking supervision

65. **The IOM has its own legal system separate from the UK, with laws being made by Tynwald.** The legal system, which is based on common law, is highly developed and well-regarded, notably in regard to expertise on financial sector matters. A full range of high-quality legal, accounting, and other business services are available on the island, and the payment system is integrated with that of the UK.

66. **The IOM has a deposit protection scheme, which was amended shortly after the time of the assessment.** Currently, maximum compensation is 100 percent of deposits up to GBP50,000 per individual depositor and GBP20,000 for other depositors. Inter-bank deposits and those of the failed bank's shareholders and directors are excluded from protection. There is no LOLR facility.

Main findings

67. **The IOM has maintained and improved on the generally very high standard of compliance with the BCP, which was noted in the previous assessment.** The FSC is commended for its proactive stance in establishing and enforcing high standards for banking supervision, which have contributed to the maintenance of the IOM's good reputation as an international banking centre.

¹⁶ The average risk weighted capital adequacy ratio at end-2007 was 16.1 percent, and profitability was high, so the starting position was strong.

68. **A significant change since the previous assessment concerns the enhanced operational autonomy of the FSC.** The Treasury now has a limited ability to specify broad policies and strategies for the FSC, leaving day-to-day operations and case-specific issues to the FSC. This arrangement may be viewed as a means to maintain some democratic control over the direction of financial sector policy generally. There is no tradition in the IOM—and indeed no evidence—of any political or governmental interference in the performance of supervision ever having occurred.

69. **Other elements supporting the FSC’s autonomy have been broadly enhanced.** There is a new requirement for board members that they not be members of Tynwald or civil servants. Public accountability requirements for the FSC have also been improved, and the FSC uses a variety of vehicles to explain its actions and policies. However, Tynwald’s approval is still required for new (or amended) regulations made by the FSC.

70. **The FSC’s present staff levels for banking supervision, although relatively small, appear to be broadly adequate.** However, the FSC’s expenditure forms part of the government’s budget and requires the FSC to obtain approval for any increase in staff or other expenditure, which may limit its ability to react to contingencies. The supervisory staff are highly trained and respected for their professionalism by commercial bank management and accounting firms.

71. **The FSC’s supervisory approach is risk-based, and incorporates both desk-based work and on-site visits.** A risk profile is assessed for every bank, together with an impact rating based on the bank’s size. These factors are then combined to determine the amount of resources the FSC should apply to its supervision of any one bank. In addition to routine “business meetings” with banks, the FSC uses its risk assessments to prioritize other on-site work. These take the form of “focus visits” in which the FSC examines specific areas (for example, internal controls) of a bank’s risk profile. In addition, the FSC conducts programs of visits across all banks to assess particular risks (themes) and banks’ ability to mitigate these risks.

72. **The FSC has continued to incorporate best international practices into the supervisory function.** With guidance from the authorities, Basel II has now been adopted by all banks, save one which has been allowed to postpone until January 2009. As the financial system develops, it may be necessary build up capacity in such areas as consolidated supervision, which is currently of little import given the structure of the banking system.

73. **The FSC has adequate powers to ensure compliance with its regulations and other orders, and it uses these powers when the occasion demands.** A broad and flexible range of sanctions are available. The FSA 2008 has given the FSC powers to petition the court for the appointment of a person to manage a bank’s business.

74. **The major risk factors facing the IOM, which have been given prominence by the global financial crisis, relate to large exposures toward parent banks.** Close

relationships with parent banks are risk-mitigants in normal times, but operate as powerful risk transmittal mechanisms when the parents come under severe stress. These exposures to related parties generally dominate local banks' balance sheets, which gives rise to major solvency and liquidity risks. The authorities recognize these concerns and the threats which they represent to overall financial stability. The FSC is commended for its proactive approach in addressing these concerns. Nonetheless, the importance of these risks require that the authorities prioritize the further development of relevant regulations and supervisory practice.

Table 12. Summary Compliance with the Basel Core Principles

Core Principle (CP)	Comments
1. Objectives, independence, powers, transparency, and cooperation	The FSC has wide powers and autonomy.
1.1 Responsibilities and objectives	Objectives are clearly stated.
1.2 Independence, accountability and transparency	Operational independence has been enhanced, and in practice the independence is not under threat. However, members of the FSC can still be removed by resolution of Tynwald for any reason, and Tynwald can reject regulations made by the FSC. The FSC is effectively accountable to government and the public.
1.3 Legal framework	The legal framework is comprehensive and kept up to date.
1.4 Legal powers	A full range of enforcement powers and sanctions are available. Fines are currently used only for infringement of administrative requirements.
1.5 Legal protection	Legal protection of supervisors is provided.
1.6 Cooperation	Means are available and used for domestic and international cooperation.
2. Permissible activities	Permissible activities are well defined. The term "bank" should be protected explicitly
3. Licensing criteria	The licensing criteria are full satisfactory.
4. Transfer of significant ownership	Recent legislation has introduced a definition of significant ownership and explicit requirements for FSC approval of major transfers of ownership.
5. Major acquisitions	Recent legislation has introduced explicit requirements for FSC approval of major acquisitions. Given the structure of the banking sector and in particular the absence of complex groups headquartered on the island, major acquisitions have not yet been an issue. However, there are as yet no established criteria for assessing proposals for major acquisitions.
6. Capital adequacy	Capital adequacy requirements are fully adequate. Basel II has been introduced.
7. Risk management process	The FSC regulates and effectively supervises risk management processes.
8. Credit risk	The FSC regulates and effectively supervises credit risk.
9. Problem assets, provisions, and reserves	Banks are required to recognize problem assets and make provisions in a timely fashion.
10. Large exposure limits	Exposures to related parent banks are generally not limited.

Core Principle (CP)	Comments
11. Exposure to related parties	Exposures to related parent banks are generally not limited, yet they constitute the main vulnerability for the system.
12. Country and transfer risks	Country and transfer risks, while limited for most banks, is adequately regulated and supervised.
13. Market risks	Market risk, while limited for most banks, is adequately regulated and supervised.
14. Liquidity risk	Local banks' liquidity management capacity is limited given the typical business model. Consideration should be given to requiring them to hold a stock of highly liquid assets in the form of marketable assets or short-term balances with non-group banks.
15. Operational risk	Operational risk is addressed. The FSC should strengthen its guidance on operational risk relating to legal risk.
16. Interest rate risk in the banking book	Interest rate risk is adequately regulated and supervised.
17. Internal control and audit	Banks are required to have effective internal controls and audit.
18. Abuse of financial services	Extensive provisions, supported by supervision, are in place to deter and prevent the abuse of financial services.
19. Supervisory approach	Cross-bank comparisons and system-wide stability analyses should be developed, for example, through more regular stress testing, evaluation of systemic developments, and review of the distribution of financial soundness indicators.
20. Supervisory techniques	The FSC makes use of an array of supervisory techniques, including sophisticated off- and on-site supervision.
21. Supervisory reporting	Supervisory reporting is fully satisfactory. It is important to ensure that strict control continue to be maintained to prevent unauthorized access to confidential data.
22. Accounting and disclosure	Banks maintain a high level of accounting and disclosure.
23. Corrective and remedial powers of supervisors	The authorities enjoy a full range of corrective and remedial powers, which they have exercised when the occasion has demanded.
24. Consolidated supervision	Although not currently of great materiality for the IOM, the FSC should establish an adequate supervisory regime for consolidated supervision.
25. Home-host relationships	The FSC actively pursues constructive cooperative relationships with home supervisors.

Recommended action plan and authorities' response

Recommended action plan

Table 13. Recommended Action Plan to Improve Compliance with the Basel Core Principles¹⁷

CP1(2)	Remove Tynwald's legal powers to remove members of the FSC by resolution and to veto proposed FSC regulations.
CP1(4)	Consideration should be given to more use of fines other than for infringement of purely administrative requirements.
CP2	Make explicit that only licensed deposit takers can use the term "bank" and derivatives thereof in relevant names.
CP5	Develop criteria for assessing major acquisitions by locally incorporated banks.
CP10	Decide on a regular basis whether or not an exemption for large exposures should be renewed.
CP11	Regularly monitor the status and financial condition of parent companies of local subsidiaries, and review whether exemptions of group-related exposures from the concentration risk requirements should be renewed.
CP14	Consider requiring banks to hold a stock of highly liquid assets in the form of marketable assets or short-term balances with non-group banks. Keep liquidity guidance under review in light of evolving international standards in this area.
CP15	Strengthen guidance on operational risk relating to legal risk.
CP19	Develop cross-bank comparisons and system-wide stability analyses, and publish more analysis.
CP24	Establish a formal supervisory regime for consolidated supervision.

Authorities' response to the assessment

Table 14. Authorities' Response to the BCP Assessment

Core Principle	Recommended Action	Authorities' Response
CP1(2)	Remove Tynwald's legal powers to remove members of the FSC by resolution and to veto proposed FSC regulations.	The Commission will ask Treasury to take forward amending legislation to address these recommendations.
CP1(4)	Consideration should be given to more use of fines other than for infringement of purely administrative requirements.	Consideration will be given to adopting this recommendation in an update to the Rulebook which is planned for 2009. Civil Penalties for submission of late returns was introduced as a first stage of a Civil Penalties regime.
CP2	Make explicit that only licensed deposit takers can use the term "bank" and	The Commission will ask the Treasury to take forward amending legislation to address this recommendation.

¹⁷ Note that several recommendations are included under CPs that are assessed as fully compliant.

Core Principle	Recommended Action	Authorities' Response
	derivatives thereof in relevant names.	
CP5	Develop criteria for assessing major acquisitions by locally incorporated banks.	The Commission can demonstrate the criteria that was used in assessing a major acquisition by a locally incorporated bank. This will be reviewed and formally adopted as the criteria to be used in the future during 2009/early 2010.
CP10	Decide on a regular basis whether or not an exemption for large exposures should be renewed.	This will be done annually.
CP11	Regularly monitor the status and financial condition of parent companies of local subsidiaries, and review whether exemptions of group-related exposures from the concentration risk requirements should be renewed.	This is already being done but more formalized procedures will be adopted.
CP14	Consider requiring banks to hold a stock of highly liquid assets in the form of marketable assets or short-term balances with non-group banks. Keep liquidity guidance under review in light of evolving international standards in this area.	This has already been discussed during 2008 and these discussions will continue in 2009. This has been implemented.
CP15	Strengthen guidance on operational risk relating to legal risk.	This will be done during 2009.
CP19	Develop cross-bank comparisons and system-wide stability analyses, and publish more analysis.	This will be done either during 2009 or early 2010.
CP24	Establish a formal supervisory regime for consolidated supervision.	This will be done during 2009/early 2010.

B. Insurance Core Principles

75. Insurance regulation in the IOM broadly meets international standards.

Regulation has been strengthened since a 2003 IMF assessment. The IPA has been putting in place MOUs with home regulators and is exchanging information extensively. Effective regulation is facilitated by a sound legal and institutional framework and by the availability of actuarial expertise. On-site supervision has been developed and extended. There are some gaps in the framework of regulations, mainly standards on corporate governance, powers and procedures for group supervision and disclosure requirements. But the IPA is working to address these.

Introduction

76. This assessment of implementation of the IAIS ICPs was undertaken as part of an IMF FSAP Update for the IOM in 2008. An IMF mission visited the IOM during September 2008. This assessment follows-up on an earlier ICP assessment performed in the context of the 2002/2003 IMF OFC assessment of the IOM.

Information and methodology used for assessment

77. The assessment of compliance with the ICPs was made based on information available in September 2008. The authorities contributed a full self-assessment and further information in response to a pre-mission questionnaire. Full documentation, including all relevant laws and regulations, was supplied. The assessment took account of discussions with the IPA in the course of the mission as well as meetings with government, insurance companies (and managers of captive companies), industry, accountancy and actuarial bodies, and the local representative of a major audit practice.

78. The assessment was based on the 2003 version of the IAIS Insurance Core Principles and Methodology. It took into account relevant IAIS standards and guidance in addition to the ICPs. It takes account of IAIS papers on the regulation of captive insurance, including a paper that has been the subject of consultation but had not been finalized or published by the IAIS at the time of the mission.

Institutional and macroeconomic setting and market structure—overview

79. The IOM is a self-governing Crown Dependency. However, it is in a monetary and customs union with the UK. The authorities have followed a strategy based on sound public finances, creation of a stable and efficient tax environment (“tax neutrality”), and the maintenance of the island’s reputation as a safe and reliable jurisdiction for locating business. This last element has been particularly important for the development of financial activities.

80. The IPA is the regulator of insurance and pensions under a number of existing laws and regulations, many of which have been consolidated in the IA 2008. In addition

to the regulation of insurance companies, its responsibilities under the IA 2008 include regulation of general insurance intermediaries (life intermediaries are regulated by the FSC) and managers of captive insurance companies; and management of the statutory compensation scheme for life insurance. The IPA is governed by a five member board, including the chief executive. Board members (referred to as members of the Authority) are appointed by the IOM Treasury subject to Tynwald approval. The Chief Executive (referred to in legislation as the Supervisor), as a member of the staff of the IPA, is appointed by the board to that position although his role as a member of the IPA Board is subject to the same appointment provisions as for other members. There are 12 staff in total.

81. **The legal and institutional framework is independent of the UK but draws heavily on U.K. standards and practices.** The Manx legal system is based largely on English common law principles. Accounting standards are set out in companies' acts and in insurance legislation. There is a local office of the Institute of Chartered Accountants of England and Wales and the ACCA. The Manx Actuarial Society is a regional society within the UK Actuarial Profession. Life insurance companies are represented by the Manx Insurance Association and captives and their managers by the Manx Insurance Managers Association.

82. **The insurance market has four categories: long-term (life) insurance, general insurance, reinsurance, and restricted (captive) insurance.** The life sector is largest with GBP8.4 billion in gross written premiums (GWP) in 2007 and GBP 38.6 billion in assets at end- 2007. There are 17 companies (as at end-March 2008), writing mainly unit-linked business. U.K. investors and U.K. expatriates in the Middle and Far East form the majority of policyholders, but business is targeted at overseas investors generally, including in the EU. Distribution is mostly through brokers and advisers operating overseas in the markets from which business originates. Captives is the next largest sub-sector (128 companies and GBP833 million in GWP, 2007). Twenty-three firms are authorized as managers of captive companies. Non-life and reinsurance are comparatively small. There is also a significant pensions sector, mostly providing defined contribution benefits (1,187 schemes with GBP1.2 billion in total assets at end-2007).

83. **Recent life insurance sector performance has been strong, though growth rates, especially in captives business, are easing.** After rapid growth in 2005 and 2006, new business volumes and investment performance have been adversely affected by weaker global equity markets. The number of captives established in the IOM has fallen, reflecting competition from jurisdictions within the EU. A major review was undertaken in late 2007 (the Bennet Report) to assess prospects for captives business and establish a program of initiatives to support the efforts of captives managers to diversify sources of business. This report also refers to the potential for developing more reinsurance business on the island.

84. **The insurance sector is highly profitable relative to its low risk profile and is also particularly well-capitalized.** Life insurance companies, which account for 80 percent of

gross premium income, have been achieving returns on equity (on a statutory accounting basis) of up to 50 percent in recent years, in the wake of sharp increases in business. Solvency has remained comfortable: relevant available net assets exceed the RMM five times over. The captive sector is even more strongly capitalized in aggregate. Many overseas insurance groups with operations in the island as well as parents of the captive companies choose to accumulate surpluses in the IOM company against future business growth or for tax management purposes.

Main findings

85. **The IOM has maintained and improved on the generally high standard of compliance with the ICP, which was noted in the previous assessment.** The IPA is commended for its proactive stance in establishing and enforcing high standards for supervision, which have contributed to the maintenance of the IOM's good reputation as an international financial centre.

86. **While the IPA has clear regulatory objectives and enjoys a high degree of operational independence, some scope remains for government and political intervention.** The IPA is, for example, dependent on government budgetary allocations to fund spending. Members of the Authority can be dismissed by the Council of Ministers with the reasons not having to be made public. However, there is no tradition in the IOM—and indeed no evidence—of any political or governmental interference in the performance of supervision ever having occurred.

87. **The IPA's supervisory approach incorporates both desk-based work and on-site visits.** The IPA has a well-structured approach to on-site work with extensive internal guidance on procedures and template letters for example. While its work to date has been driven by the high priority given to introducing stronger AML/CFT rules, a significant development recently is that it is broadening the onsite program to cover all aspects of all insurance companies' business over the next few years.

88. **The IPA has adequate powers to ensure compliance with its requirements and it uses these powers when the occasion demands.** The IPA's approach is informed by its ability to communicate regularly with the small number of insurance companies and captive managers on the island. This makes it easy to address concerns in the first instance through supervisory dialogue and discussion. However, a broad and flexible range of sanctions are available.

89. **There are some gaps in the framework of regulations, although the IPA is already working to address most of these.** There are no industry-specific standards on corporate governance and related issues. However, the IPA is close to adopting new binding guidance setting out its expectations in these areas. It already covers governance and related issues in its onsite work. The other significant areas for enhancements are:

- (i) Powers and procedures for group supervision, for the limited number of cases where this is necessary. The IPA is focused on supervision of the solo entity and cooperation with the supervisors of the parent group. In the majority of cases, this is sufficient to address risks in IOM authorized companies appropriately. But, there are some cases—and could be more in the future—where it is appropriate for the IPA to carry out, or ensure that another regulator carries out, a test of group solvency, informed if possible by a wider assessment of the risks to the group.
- (ii) Disclosure requirements, which the IPA is now working on, taking into account relevant IAIS standards.

90. **The IPA faces challenges in the future, including developing a response to the EU’s Solvency II directive.** The IPA’s resources are small (12 staff in total for insurance and pensions), but skilled individuals have been recruited to assist in the further development of its work (including onsite supervision, which recently has been focused on strengthening AML/CFT rules). While the existing regime for reserving and solvency is sound, the IPA will face challenges in developing a response to Solvency II, which, while not binding on the IOM, will affect most parent groups and set a new international standard. The IPA is also standing ready to respond to any development of major new lines of insurance business on the Island (there is interest in attracting reinsurance) and is keeping its resource needs under review.

Table 15. Summary Compliance with the Insurance Core Principles

Insurance Core Principle (ICP)	Comments
ICP1 - conditions for effective insurance supervision	The IOM has well-defined, transparent and effective policy, legal and institutional frameworks for insurance business and access to well-functioning financial markets. The jurisdiction benefits from the good availability of professional services locally and through access to the resources of major practices in the UK and elsewhere.
ICP2 - Supervisory objectives	The IPA has clear and appropriate objectives and there is a clear understanding among staff of the objectives and approach to regulation and the distinction between regulation and promotion of the insurance sector.
ICP3 - Supervisory authority	There are aspects of the institutional framework that could in certain circumstances constrain its ability to meet its regulatory objectives: the ability of the Council of Ministers to dismiss the IPA Board, the Tynwald power to annul Regulations, and the funding arrangements. In practice, however, the IPA enjoys a high degree of operational independence from government.
ICP4 - Supervisory process	The IPA conducts its functions in a transparent and accountable manner. Comprehensive information on its activities is provided to government, Tynwald, and the public through various means.
ICP5 – Supervisory cooperation and information sharing	The IPA is well-apprised of the importance of exchanging information with other supervisors, particularly given the significant presence of international groups on the Island. It is extending its program of MOUs and is committed to becoming a signatory to the IAIS Multilateral MOU. It exchanges information in practice, both under MOUs and where otherwise requested.
ICP6 – Licensing	There is a comprehensive framework for the licensing of insurance business. A significant recent development in the IA 2008 has been the extension of provisions enabling the IPA to authorize companies from outside the EU

Insurance Core Principle (ICP)	Comments
	establishing as branches in the Island and to exempt them from some prudential requirements. In practice, the number of companies applying for such treatment is expected to be limited.
ICP7 – Suitability of persons	There is a comprehensive framework for considering the suitability of key persons.
ICP8 – Changes in control and portfolio transfers	There is a comprehensive framework for the regulation of changes in control and portfolio transfers. While there is less need to regulate transfers of non-life portfolios (mostly captives) and they are not covered by the current framework, they will be brought within it under the forthcoming regulations. In the interim, planned new binding guidance on corporate governance will require insurers to notify the IPA in advance of all proposed transfers.
ICP9 – Corporate governance	The IPA is committed to setting and enforcing high governance standards. It is able to require specific action from firms. It has taken supervisory and enforcement action in relation to weak governance. The combination of Companies Act requirements and IPA's supervision and enforcement work has created a broadly effective framework of governance requirements. However, the planned new binding guidance on corporate governance, expected to take effect by the end of 2009, will help to ensure that all firms are aware of the detailed standards expected of them.
ICP10 – Internal controls	Comments recorded on corporate governance under ICP 9 apply for internal controls also.
ICP11 – Market analysis	The IPA monitors developments in the markets through its relationships with insurers and trade associations and its membership of international supervisory groups.
ICP12 – Reporting to supervisors and off-site monitoring	The IPA has a well-developed process for analyzing annual returns and taking follow-up action. The IPA by choice employs no qualified actuaries and the offsite work therefore relies on consultants based in the UK for the analysis of the most technical issues. This relationship, which has now been in place for a number of years, functions effectively. Supervisory staff take responsibility for the communication and follow-up of issues at all stages of the process.
ICP13 - On-site inspection	The IPA has a well-structured approach to onsite work with extensive internal guidance on procedures, template letters, etc. While its work to date has been driven by the high priority given to AML compliance, it is now starting to broaden the onsite program to cover all aspects of all insurance companies' business over the next few years. This is a necessary and significant enhancement in onsite work that will require careful management to avoid resourcing strains.
ICP14 - Preventive and corrective measures	The IPA's approach is informed by its ability to communicate regularly with the small number of insurance companies and captive managers on the Island. This makes it easy to address concerns in the first instance through supervisory dialogue and discussion. However, the IPA also has the necessary powers and has used them in practice to impose more formal requirements of firms in the event of actual or expected concerns.
ICP15 - Enforcement or sanctions	The IPA rarely in practice uses its extensive formal powers. However, the availability of powers has been helpful to the IPA in reinforcing its supervisory actions. Market perceptions are that the IPA is ready and willing to use formal enforcement powers where options for supervisory action have been exhausted or where serious breaches of its requirements have taken place.
ICP16 - Winding-up or exit from the market	The framework provides for appropriate routes for orderly exit, sets out the procedures for dealing with insolvency and, for life insurance business, provides for mechanisms to protect policyholders as far as possible, particularly through transfer of policies to another insurer. The framework has not been tested in practice as no life insurer has failed; nor has the IPA ever

Insurance Core Principle (ICP)	Comments
	sought a winding up.
ICP17 - Group-wide supervision	The IPA is focused on supervision of the solo entity and cooperation with the supervisors of the parent group. In the majority of cases, this is sufficient to address risks in IOM-authorized companies appropriately. But there are some cases—and could be more in the future—where it is appropriate for the IPA to carry out, or ensure that another regulator carries out, a test of group solvency, informed if possible by a wider assessment of the risks to the group.
ICP18 - Risk assessment and management	Comments recorded on corporate governance under ICP 9 apply for internal controls.
ICP19 - Insurance activity	The IPA has adequate powers and procedures to ensure insurance companies have the tools required to price business and manage their insurance risks effectively.
ICP20 - Liabilities	The IPA has a developed framework of requirements for the establishment of adequate technical provisions. Its supervisory staff and actuarial consultants work together on the assessment of individual firms' provisions.
ICP21 - Investments	The IPA has an adequate framework of requirements on insurers' investments.
ICP22 - Derivatives and similar commitments	The use of derivatives by insurers in the IOM is limited to life insurers. While more relevant to observance with ICP 18, the introduction of the planned new binding guidance on corporate governance and related issues will helpfully set out the IPA's expectations in these areas also.
ICP23 - Capital adequacy and solvency	The IPA has a well-founded framework of solvency regulations that combine a hard minimum requirement with a flexible approach to setting higher minimum standards for individual firms to reflect their risk profiles. It has well-defined processes to monitor actual capital levels and to respond to breaches of minimum requirements.
ICP24 - Intermediaries	There are extensive requirements applying to intermediaries under the IPA (general insurance) and FSC (life insurance) regimes. The IPA's powers over general insurance intermediaries have been extended under the IA 2008.
ICP25 - Consumer protection	As for a number of other ICPs, the introduction of the planned new binding guidance on corporate governance and related issues will helpfully set out the IPA's expectations in these areas. There are no explicit requirements in the IA 2008 itself, even at a high level. But the IPA attaches importance to high standards and covers market conduct in its supervision and enforcement work.
ICP26 – Information, disclosure and transparency towards markets	There are no disclosure requirements. But the IPA is engaged with the industry on the development of standards. It is not clear when this may result in requirements taking effect.
ICP27 - Fraud	While the IPA has a range of powers to ensure that insurance companies address fraud risks (and it covers the issues in supervisory work), it lacks standards on internal controls in this area. The planned new binding guidance on corporate governance and related issues will deliver these.
ICP28 - Anti-money-laundering, combating the financing of terrorism	The IPA has a well-developed set of requirements, especially (and appropriately) for life insurance business. It has also been making AML issues a priority for on-site work. See also the AML/CFT ROSC.

Recommended action plan and authorities' response

Recommended action plan

Table 16. Recommended Action Plan to Improve Compliance with the Insurance Core Principles

Principle	Recommended Action
ICP3 - Supervisory authority	The authorities should address those parts of the institutional arrangements for the IPA that leave scope for government intervention: the provisions for dismissal of Board members of the IPA, the provision for Tynwald to annul Regulations and the funding arrangements.
ICP9 - Corporate governance ICP10 - Internal controls ICP18 - Risk assessment and management ICP25 - Consumer protection ICP27 - Fraud	The IPA needs to complete as soon as possible its work on a comprehensive new binding guidance on corporate governance and related issues to ensure that all firms are aware of the detailed standards which are expected of them in these areas.
ICP17 - Group-wide supervision	The IPA needs to have powers and processes to carry out group supervision - a test of group solvency, informed if possible by a wider assessment of the risks to the group. Its approach will need to be kept under review as IAIS policy in the area of group supervision continues to develop.
ICP26 – Disclosure and Transparency	The IPA should introduce disclosure requirements for insurance companies (other than pure captives), having consulted with the industry and other stakeholders on what information will be most useful. Alternatively, the IPA could consider putting itself in a position where it can publish supervisory returns itself.

Authorities' response to the assessment

91. The assessment is a fair and accurate summary of the position in relation to insurance regulation in the IOM as at the date of the assessment.

92. **In response to the specific recommended action points set out in the table above the IPA would comment as follows:**

- (i) ICP3: The IPA will be discussing these matters further with the Treasury to examine how they might be addressed.
- (ii) ICP9,10,18,25, and 27: In order to address these points the IPA is continuing to develop its draft binding guidance on corporate governance and expects to issue this for consultation in April 2009 with a view to implementing it by the end of 2009.

- (iii) ICP17: The IPA is currently considering this issue with a view to developing and implementing appropriate requirements using the enabling provisions available to it under the IA 2008 and taking into account the IAIS's continuing work in this area.
- (iv) ICP26: The IPA's current preference in this matter is for relevant companies to be required to publish certain information in due course, rather than the IPA publish it itself. To this end it will continue its discussions with the Manx Actuarial Society with a view to setting out some initial principles, taking into account the detailed provisions of this ICP and the IAIS's various published standards.

C. FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism

Introduction

93. This ROSC for the FATF 40 Recommendations for AML and 9 Special Recommendations for CFT was prepared by staff of the IMF. The report provides a summary of the AML/CFT measures in place in the IOM and of the level of compliance with the FATF Recommendations, and contains recommendations on how the system could be strengthened. The assessment was conducted using the 2004 Methodology and is based on the information available at the time it was completed on September 18, 2008, or shortly thereafter. The detailed assessment report on which this ROSC is based has been agreed with the IOM authorities. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the authorities of the IOM or the Executive Board of the IMF.

Key findings

94. The IOM is an international financial center of some significance based in particular on the provision of banking and insurance-related products to nonresidents; funds business has been a growing sector and the IOM has also licensed some online gambling businesses. The financial services sector represents the single largest component of the economy (36 percent of GDP). The IOM has its own legal system and jurisprudence based on the principles of English common law. Standards of governance and transparency appear to be high. Much of the financial services business in the IOM is, directly or indirectly, UK-related and the IOM financial institutions, many of which are subsidiaries of UK banks, are substantial providers of liquidity to the U.K. money markets. A key reason for the growth in recent years in the IOM's financial services sector remains its competitive tax regime. In that regard, the IOM authorities are placing enhanced emphasis on international cooperation, including through working closely with the relevant Organization for Economic Cooperation and Development initiative and entering into tax information exchange agreements (TIEAs).

95. The IOM is broadly compliant with most aspects of the FATF Recommendations, having upgraded its requirements significantly, particularly in the second half of 2008. Most of the deficiencies noted are technical in nature. While the IOM government has not published an AML/CFT strategy, as such, a political commitment has been given by the IOM authorities, in correspondence with the FATF and in public statements, to adhere to the principles of the FATF Recommendations. Although the IOM is a low-crime jurisdiction, some characteristics of the financial system point to an increased potential of abuse for ML or FT purposes, as more than 90 percent of the business, often established through introducers, is conducted on a non face-to-face basis for nonresidents, and services provided include private banking and the use of legal persons and arrangements such as trusts, which can make it more difficult to identify the customer and the ultimate beneficial owner.

96. ML is criminalized broadly in line with the international standard and many, albeit not all, technical aspects of the Vienna and Palermo Conventions are complied with. All categories of predicate offenses listed in the international standard are covered. While the statutory sanctions for ML-related offenses are, in a formal sense, comprehensive, dissuasive, and proportionate, the sentences actually imposed by the courts appear rather low. Although a few deficiencies are identified in this report, the IOM's legal framework underpinning the seizure and confiscation system related to proceeds of crime is generally solid and comprehensive. With regard to combating the financing of terrorism, the implementation by the IOM of UNSCRs 1267 and 1373, as well as the 2001 and 2002 EC Regulations, follows that of the UK.

97. The FCU, in acting as the FIU, is performing its role adequately and receives a reasonable flow of STRs, mainly from financial institutions. Within the FCU, there is a clear separation between the intelligence and the investigative side of the handling of the reports. However, the low number of cases in which STRs result in investigations, and ultimately in a prosecution, raises an effectiveness issue that needs to be addressed. Additional resources are being provided to the FCU.

98. The IOM has recently formally adopted a risk-based approach to the application of AML/CFT measures. License holders are required to conduct a risk assessment of their businesses and customers and tailor their CDD procedures accordingly, with enhanced CDD required where higher risks are identified.

99. With the latest revisions, the IOM has brought its AML/CFT preventive measures largely into compliance with the FATF Recommendations. The recently-enhanced requirements include those relating to conducting business with PEPs and the controls over reliance, which may be placed by the IOM financial sector on business introducers to conduct certain CDD measures. However, there are a few instances where the available concessions go beyond a reasonable interpretation of the FATF Recommendations.

100. The IOM's financial institutions are generally well supervised for AML/CFT purposes. The range of available administrative sanctions should be enhanced. Implementation of requirements by financial institutions appeared generally good, if somewhat variable, and the authorities plan additional AML/CFT on-site inspections, particularly for the banking and insurance sectors.

101. CDD obligations for DNFBPs largely mirror those for financial institutions. CSPs and TSPs conduct substantial cross-border and non face-to-face business and are regulated and closely supervised by the FSC. The on-line gaming sector's entire business, while small, is subject to inherent challenges in relation to CDD. The Department of Home Affairs (DHA) has overall AML/CFT responsibility for the remaining DNFBPs and was at an advanced stage of developing appropriate measures for DNFBPs to supplement requirements in place for TSPs, CSPs, and most lawyers.

102. The company registration system is well developed and operates within the structures of the FSC. Trusts have long been recognized under the IOM law, but are not subject to a registration system.

103. As a British Crown Dependency, the IOM is not empowered to sign or ratify international conventions on its own behalf but, following a request by the IOM Government, the UK may extend the ratification of any convention to the IOM. The Vienna Convention and FT Convention have been extended to the IOM, but a request has not yet been made with respect to the Palermo Convention. The range of MLA that can be provided by the IOM is broad. MLA requests are frequent and are dealt with constructively and efficiently. Overall, the IOM authorities take their responsibilities in the area of international cooperation seriously, including in the FIU (applying Egmont Group principles) and in the financial supervisory area. Domestic coordination and cooperation is well developed, particularly through the initiatives of the Joint AML Advisory Group.

Legal systems and related institutional measures

104. ML is criminalized broadly in line with the international standard and most technical aspects of the Vienna and Palermo Conventions are complied with. All relevant categories of predicate offenses are covered. For the offense of “acquisition, possession or use,” IOM law provides for a defense of “having given adequate consideration” for illicit funds received, which could be open to abuse. Also, the purpose requirements for the various acts constituting ML are narrower than in the conventions and the scope of the ML provision for terrorism-related predicate offenses is also too narrow.

105. The ML offenses extend to all property that represents the proceeds of crime. Self laundering is criminalized for all money laundering offenses except “acquisition, possession and use.” All ancillary offenses are criminalized in line with the standard. The *mens rea* requirement varies depending on the money laundering offenses applicable in the specific case. However, at a minimum, a person may be held criminally liable if he acted intentionally and with the knowledge that the property involved stems from a criminal source. Based on an English common law principle, intent may be inferred from objective factual circumstances. Criminal liability extends to legal persons.

106. While the statutory sanctions for ML are in a formal sense comprehensive, dissuasive, and proportionate, the sentences actually imposed by the courts appear rather low. There have been no convictions for autonomous ML and the low number of domestic investigations or prosecutions supports the conclusion that ML is not yet dealt with as a stand-alone offense.

107. While financing of terrorism is criminalized under the IOM law, the definition of the offense does not cover all elements under the FT Convention. While the financing of individual terrorists is criminalized under the IOM law in line with the international standard,

it is unclear whether coverage extends to situations where the funding relates to living or other private expenses. There were no prosecutions or convictions for terrorist financing.

108. The IOM legal framework for seizure and confiscation of proceeds of crime is comprehensive. The provisions allow for a value-based confiscation regime subject to a detailed court assessment procedure. The provisions of ATCA 2003 also appropriately focus on the deprivation of the assets related to terrorism financing (FT). However, some issues need to be addressed, particularly the impact of the lacunae in the scope of criminalization of ML and FT and that the *corpus delicti* confiscation of the assets laundered is untested and its application doubtful. Equivalent value seizure appears not to be fully covered and the issue identified in the IMF's 2002/03 assessment of nonavailability in the IOM of confiscation of assets of equivalent value in connection with FT remains unresolved.

109. The implementation of UNSCRs 1267 and 1373, as well as the 2001 and 2002 EC Regulations, is closely linked to that of the UK. All UK lists become automatically incorporated in the IOM freezing regime. Although this has not yet been used in practice, the IOM has its own listing and freezing provisions in ATCA Part VII. However, the ATCA provisions are insufficient to ensure a comprehensive preventive, pre-investigative approach as required by the international standards.

110. The FCU, an active member of the Egmont Group since 2000, acts as the FIU for the IOM. It is a joint police/customs unit supported by civilian personnel. It is operationally independent and its specific remit as a receiving and processing agency for ML and FT-related disclosures by the regulated sectors is formalized in the AML Code 2008. The FCU is structured such that its financial intelligence unit operates separately from its investigative law enforcement unit. The statistics spanning the period 2004–08 show reasonable reporting levels by the financial sector, though there is some scope to improve timeliness of reporting, while reporting levels by some categories of DNFBP appear low. A weakness is that the FIU has no powers of direct or indirect access to financial and other additional information in following up on STRs submitted to it.

111. The number of STRs resulting in an investigation (six in two years) is low, and only two prosecutions have been instituted in cases that originated with an STR. While the nature of much of the financial services business conducted in the IOM involving funds received from abroad on behalf of nonresidents can make it difficult to prosecute ML cases locally and more efficient to transfer cases to other jurisdictions in which the predicate offense may have occurred or the funds or accused persons are located, the assessors consider it important that the IOM seeks also to develop its own case law in this area. This is an effectiveness issue to be addressed for the system as a whole.

112. With regard to the cross-border physical transportation of currency, the IOM opted for a declaration system, in line with the regime in force at the external borders of the EU,

which imposes an obligation on persons importing into or exporting from the IOM to declare cash and bearer-negotiable instruments of more than EUR 10,000.

Preventive measures—financial institutions

113. Coverage of preventive measures in the IOM includes all of the main financial businesses covered by the FATF definition of “financial institution.” Banking, investment services, CSPs, and TSPs are licensed and supervised (including for AML/CFT) by the FSC, while insurance business is regulated by the IPA.

114. With the significant upgrading of requirements between August and mid-December 2008, the IOM has brought its AML/CFT preventive measures broadly into compliance with the FATF Recommendations. Anonymous accounts and accounts in fictitious names are effectively prohibited through secondary legislation. The AML Code 2008 includes an obligation to identify (and to take reasonable steps to verify) all customers and beneficial owners. Appropriate requirements apply in relation to legal persons, parties to legal arrangements, and persons acting on behalf of others. The latest amendments also limited the previous scope regarding the timing of initial CDD. The requirements for occasional transactions are in line with the standard. However, there are instances where the CDD concessions go beyond a reasonable interpretation of the FATF Recommendations (e.g., fiduciary business).

115. The quality of implementation of AML/CFT measures in financial institutions was found to be mostly of a high standard. Most financial institutions indicated that they apply CDD measures using the permitted risk-based approach. However, the assessors questioned whether they were taking fully into account the increased risk of nonresident non face-to-face business and noted the uneven level of controls applied in practice in some institutions in relying on third parties to conduct CDD.

116. The AML Code 2008 introduced requirements fully in line with the standard with respect to PEP-related business. This amendment mirrors the requirements already in place for all entities subject to FSC and IPA-issued requirements, and the assessors found a high level of awareness and compliance by financial institutions with the requirements for PEPs. The AML Code 2008 also introduced a requirement for appropriate procedures to prevent the misuse of technological developments, though no detail was included; the issuing of additional guidance was recommended. The assessors welcomed the introduction of a requirement for adequate measures to compensate for any risk arising as a result of dealing with an applicant for business otherwise than face-to-face.

117. The IOM authorities have developed a protocol to accommodate the use of business introducers by IOM entities to eliminate duplication of effort and documentation in cases that meet a set of detailed conditions. Some financial institutions place full reliance on such third parties while others are very selective. The regulatory authorities should continue to focus attention on this area as part of their onsite inspection programs.

118. Requirements in secondary legislation address ongoing due diligence and reporting of suspicious transactions to the FCU, and are supported by detailed guidance. However, protection for suspicious transaction reporting is not as broad as the standard requires in some respects and is also not limited to good faith reporting. Record keeping requirements have been brought fully into line with the standard. There are no secrecy provisions in legislation to inhibit implementation of AML/CFT requirements. Requirements for ongoing due diligence are well developed and comprehensive. However, a more formal approach is needed for application of enhanced measures, including countermeasures, in relation to jurisdictions that do not or inadequately comply with the FATF Recommendations. There are comprehensive requirements, supported by detailed guidance, for the implementation of adequate AML/CFT internal policies, procedures, and controls, with the exception that the audit requirements do not explicitly include AML/CFT within their scope.

119. With regard to wire transfers, the IOM opted to implement European Regulation 1781/2006 on Wire Transfers, with appropriate modifications. The UK obtained from EU member states a derogation so that a reduced information requirement can apply to payments passing between the UK and the IOM. Informal funds transfer systems do not appear to be relevant in the IOM.

120. There is no explicit prohibition on the establishing a shell bank in the IOM but an FSC license is required to take deposits and will not be issued unless the FSC is satisfied that the applicant is managed and controlled in the IOM. For the most part, IOM financial institutions are subject to adequate AML/CFT regulation and supervision, although in some significant areas (banking, insurance) there is a need for additional AML/CFT on-site supervision. All IOM financial institutions have a designated regulatory authority for AML/CFT purposes. FSC supervision follows its published Supervisory Approach which provides for an on-site visit cycle of between one and three years, depending on risk. The FSC plans a round of AML/CFT-themed focus visits for 2009/10 to test compliance with the latest requirements. For the IPA, additional inspections are planned from 2009.

121. The range of sanctions at the FSC's and IPA's disposal is broad and, for serious breaches, 'fit and proper' directions are used. A limitation for the FSC is that it must issue regulations in order to apply its power of financial penalty in new areas, and has yet to do so in the AML/CFT area.

122. With regard to the effectiveness of implementation, the assessors found a high level of awareness of AML/CFT risks, typologies, and international and IOM requirements across all financial institutions interviewed. Relatively few weaknesses were identified.

Preventive measures—designated nonfinancial businesses and professions

123. CDD obligations for DNFBPs are largely the same as those for financial institutions and are subject to the same strengths and weaknesses. The TSP and CSP sector forms an integral part of the financial services industry of the IOM and they are authorized and

supervised actively by the FSC, with particular focus on AML/CFT compliance. There are approximately 22,000 trusts and 42,000 companies managed or administered in or from the IOM by TSPs and CSPs, respectively.

124. The on-line gaming sector's entire business is conducted on a non face-to-face basis, with identification via electronic means. The Gambling Supervision Commission (GSC) authorized and supervises a terrestrial casino and 11 on-line casinos, offering a variety of gambling options.

125. The legal profession consists of advocates (licensed in the IOM to practice law) and registered legal practitioners (registered in other prescribed jurisdictions). Both types are subject to the AML Code 2008 but only the former are members of the IOM Law Society, while the latter are not subject to any IOM supervision, as would be required for compliance with the standard. The IOM accounting profession is subject to the AML Code 2008. At the time of the assessment, the DHA was in negotiations with the accountancy bodies to agree a program for ongoing monitoring of the sector's compliance with AML/CFT requirements. Real estate agents and dealers in precious stones and precious metals are also subject to the AML Code 2008 and the DHA has been developing measures for other nonfinancial businesses.

126. Implementation of AML/CFT measures for DNFBPs (other than TSPs, CSPs, and most lawyers) was still being developed. Overall, the DNFBPs interviewed by the assessors seemed to be well informed about their obligations with respect to CDD and record keeping requirements. The FSC devotes substantial resources with a view to improving AML/CFT compliance of TSPs and CSPs.

Legal persons and arrangements & non-profit organizations

127. The IOM has three sets of laws governing legal persons, namely the Companies Act 1931-2004, the Companies Act 2006, and the Limited Liabilities Companies Act 1996. Trusts have been recognized under IOM law for many years and are subject to the Trustee Act 1961 and its subsequent amendments. In addition, the common law principles of trust law and equity are applied and recognized by the courts. About 31,000 companies and 23,000 trusts were set up under the IOM law.

128. The IOM relies primarily on its licensed TSPs and CSPs to obtain, verify, and retain records of the beneficial ownership and control of legal persons and arrangements. All IOM legal entities incorporated under the Companies Act 2006 must utilize the services of and identify to the Companies Registry the respective CSP. Of the IOM companies otherwise registered, an estimated 70 percent utilize the services of CSPs, with the balance comprising mainly local businesses. The number of trusts administered by TSPs is unknown and trusts are not registered in the IOM.

129. TSPs and CSPs must identify in all cases the natural person who ultimately owns or controls a customer or a person on whose behalf a transaction is being conducted and take reasonable steps to verify their identity. For those companies or legal arrangements not utilizing the services of licensed TSPs or CSPs, no formal measures are in place regarding beneficial ownership information. Persons providing director services and nominee shareholders, protectors/enforcers, and letter of wishes are permitted and frequently used for trusts under the IOM law.

130. The IOM charitable bodies are registered with the General Registry, which has undertaken a desk-top review of registered charities' objectives and mandates. While no evidence of abuse for FT purposes was identified, authorities are proceeding with a planned review of the sector.

National and international cooperation

131. As a British Crown Dependency, the IOM is not empowered to sign or ratify international conventions on its own behalf but, following a request by the IOM government, the UK may extend the ratification of any convention to the IOM. The Vienna Convention was extended to the IOM in 1993. However, extension of the Palermo Convention has not yet been requested as IOM law does not yet comply with all its provisions. The UK extended ratification of the UN Convention for the Suppression of the Financing of Terrorism to the IOM in 2008.

132. The range of mutual legal assistance that can be provided by the IOM is broad. MLA requests are frequent and make up a substantial part of the workload of the Attorney General's (AG) Chambers and the FCU and are dealt with constructively and efficiently. There have been no refusals on record since 2004. The IOM authorities take their responsibilities in the area of international cooperation seriously, including in the FIU (applying Egmont Group principles) and in financial supervision, most notably under the IOSCO multilateral MOU. Domestic coordination and cooperation is well developed, particularly through the initiatives of the Joint AML Advisory Group, through which all relevant authorities are represented, and through extensive consultation with the financial institutions and other businesses subject to supervision for AML/CFT purposes.

Other issues

133. While the relevant authorities are generally well resourced, there is a case for additional resources for the regulatory authorities to be applied to AML/CFT on-site inspection work, particularly for banks and insurance businesses. Additional AML/CFT resources are also needed by the GSC and DHA. The authorities have approved additional resources for the FCU.

134. Relevant statistics are well maintained in most areas, including by the regulatory authorities. However, comprehensive statistics are not maintained on seizures and confiscations.

Table 17. Compliance Ratings and Key Recommendations to Improve the AML/CFT System

<p>Compliant (C): the Recommendation is fully observed with respect to all essential criteria.</p> <p>Largely compliant (LC): there are only minor shortcomings, with a large majority of the essential criteria being fully met.</p> <p>Partially compliant (PC): the country has taken some substantive action and complies with some of the essential criteria.</p> <p>Non-compliant (NC): there are major shortcomings, with a large majority of the essential criteria not being met.</p> <p>Not applicable (NA): a requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country.</p>	
FATF 40+9 Recommendations and Ratings	Key Assessor Recommendations
Legal System & Related Institutional Measures	
<p>Criminalization of Money Laundering</p> <p>R.1 PC</p> <p>R.2 LC</p>	<ul style="list-style-type: none"> Amend Articles 17C CJA 1990 and 45 DTA 1996 to: <ul style="list-style-type: none"> provide for two alternative purposes for the acts of converting and transferring proceeds, namely to avoid prosecution for the predicate offense or to conceal the illicit origin of the funds, and; eliminate the purpose requirement for the acts of converting and transferring proceeds of crime. The defense (payment of adequate consideration) provided for in Sections 17B(3) CJA 1990 and 47(3) DTA 1996 is not provided for in the Vienna and Palermo Conventions and should be eliminated as it may allow money launderers to abuse the provision to avoid criminal liability for the acquisition, possession, or use of criminal proceeds/proceeds. Amend Section 10 ATCA 2003 to cover all material elements of the ML provisions of the Palermo and Vienna Conventions. Amend the offenses of acquisition, possession, or use in the CJA 1990 and the DTA 1996 as well as the money laundering offense contained in the ATCA 2003 to include criminal proceeds obtained through the commission of a predicate offense by the self launderer. The authorities should: <ul style="list-style-type: none"> (i) address any barriers to stand-alone ML prosecutions, including the level of proof needed to determine that property stems from the commission of a specific predicate offense; and (ii) take steps to develop jurisprudence on autonomous money laundering to establish that ML is a stand-alone offense.
<p>Criminalization of Terrorist Financing</p> <p>SR.II LC</p>	<ul style="list-style-type: none"> Amend Article 1 ATCA 2003 to include a reference not only to governments, but also to international organizations. Amend the definition of “terrorism” in Section 1 ATCA 2003 to extend to all terrorism offenses as defined in the nine Conventions and Protocols listed in the Annex to the FT Convention. Consider the impact of the including in the FT offense “intention of advancing a political, religious or ideological cause” on IOM’s ability to successfully prosecute in factual settings contemplated by the FT Convention.
<p>Confiscation, freezing, seizing of proceeds of crime</p> <p>R.3 PC</p>	<ul style="list-style-type: none"> The law should be amended to address the deficiencies affecting the scope of the ML and FT offenses and thereby also improve the quality of the criminal confiscation regime.

	<ul style="list-style-type: none"> • The law should be amended to: <ul style="list-style-type: none"> -Allow equivalent value seizure at any stage of the investigation; and -Address in ATCA 2003 the issue of equivalent value confiscation in the context of FT-related assets. • Case law should be developed on stand-alone ML confiscations. • The authorities should address the low effectiveness of the current asset recovery measures, particularly by focusing on the timely tracing and immobilization of recoverable or realizable assets
Freezing of funds used for terrorist financing SR.III PC	<ul style="list-style-type: none"> • Put in place a formal procedure governing the receipt and assessment of requests based on foreign freezing lists, as required by UNSCR 1373. • Amend the legal framework implementing the UN Resolutions and EC Regulations to expressly extend the definition of ‘funds’ subject to freezing to cover assets ‘jointly’ or ‘indirectly’ owned or controlled by the relevant persons. • Amend the legal framework for the implementation of the EC Regulations to provide a procedure for considering requests for delisting or unfreezing. • Provide for and publicize a clear procedure enabling access to UNSCR 1267 frozen funds for humanitarian purposes and to cover basic expenses.
The Financial Intelligence Unit and its functions R.26 LC	<ul style="list-style-type: none"> • The authorities should supplement the current informal arrangement by providing formally for access by the FIU to additional information held by covered entities, for use in its analytical work. • The FCU and other authorities should implement steps to improve the effectiveness of the reporting system to support an increase in the number of investigations and (potentially) prosecutions and in funds and other assets frozen.
Law enforcement, prosecution and other competent authorities R.27 LC R.28 C	<ul style="list-style-type: none"> • The authorities should implement steps to improve effectiveness by seeking to increase the number of investigations and prosecutions pursued domestically.
Cross Border Declaration or disclosure SR.IX LC	<ul style="list-style-type: none"> • The cross-border control requirements should be extended to cover cash transportation by mail between the UK and the IOM.
Preventive Measures: Financial Institutions	
Customer due diligence, including enhanced or reduced measures R.5 PC R.6 C R.7 C R.8 LC	R.5 <ul style="list-style-type: none"> • The authorities should take steps to eliminate any residual inconsistencies in AML/CFT legal requirements and terminology. • The authorities should expand the current list of categories of higher-risk customers and consider including, for example, private banking and business involving trusts or other legal arrangements. • The authorities should conduct a risk-based review of the current scope of the Acceptable Applicant facility and, if warranted, limit its availability for consistency with the FATF Recommendations. To comply with the FATF Recommendations, financial institutions should be required in all cases to determine whether a customer is acting on behalf of another person and should take reasonable steps to obtain sufficient identification data to verify the identity of that other person. • If the exceptions to the CDD requirements of secondary legislation as currently set out in the FSC Handbook are to be retained, the authorities should amend the secondary legislation as necessary to provide for them. • Should the authorities decide to continue allowing source of funds to be used as principal evidence of identity in certain low-risk circumstances, the

	<p>requirements should be tightened further to eliminate any remaining risk of abuse for ML or FT purposes.</p> <ul style="list-style-type: none"> • The authorities should review on a risk basis the implementation of the concession allowing operations to commence prior to completion of full CDD procedures to ensure it is not being misused. • The authorities should ensure that insurance managers and insurance intermediaries are included within the scope of all relevant AML/CFT requirements. • The authorities should consider reducing significantly the current EUR 15,000 threshold for the application of CDD measures to one-off transactions by money and value transfer (MVT) service providers. <p>R.8</p> <ul style="list-style-type: none"> • To support the implementation of the basic requirement in this area, the authorities should issue more detailed guidance on the specific ML and FT risks of new technologies, for example in relation to e-money and e-commerce.
<p>Third parties and introduced business</p> <p>R.9 LC</p>	<ul style="list-style-type: none"> • The authorities should review the range of business introducers in respect of which concessions are applied to ensure that all categories are subject to equivalent AML/CFT requirements. • By means of on-site supervision or otherwise, the regulatory authorities should assess the effectiveness of CDD being obtained from Eligible Introducers or Introducers including, in the case of insurers, the use and effectiveness of Introducer's Certificates. • The authorities should remove any residual inconsistencies in secondary legislation following the coming into force of the AML Code 2008.
<p>Financial institution secrecy or confidentiality</p> <p>R.4 LC</p>	<ul style="list-style-type: none"> • The authorities should bring into force the provision that financial institutions do not breach their confidentiality duty in exchanging customer information between themselves for AML/CFT purposes.
<p>Record keeping and wire transfer rules</p> <p>R.10 C SR.VII LC</p>	<p>SR.VII</p> <ul style="list-style-type: none"> • The FSC should reconsider whether the current implementation of the risk-based approach for incoming wire transfers lacking full originator information accurately reflects the level of underlying risk. • The FSC should continue to include wire transfers within its program of on-site supervision.
<p>Monitoring of transactions and relationships</p> <p>R.11 C R.21 LC</p>	<ul style="list-style-type: none"> • The authorities should formalize appropriate means of applying counter-measures to countries that do not or insufficiently apply the FATF Recommendations.
<p>Suspicious transaction reports and other reporting</p> <p>R.13 LC R.14 PC R.19 C R.25 LC SR.IV PC</p>	<p>R.13</p> <ul style="list-style-type: none"> • The FCU and supervisory authorities should take steps to enhance the timeliness of reporting of suspicious transactions to the FCU. • The law should be amended to provide comprehensively that suspicious attempted transactions must be reported promptly to the FCU. <p>R.14</p> <ul style="list-style-type: none"> • The authorities should amend the law to extend the protection for persons reporting suspicions to the FIU to cover all aspects in the international standard and limit the protection to reporting in good faith. • The authorities should consider introducing measures to ensure the confidentiality, including in Court proceedings, of persons reporting suspicions to the FIU.

	<p>SR.IV</p> <ul style="list-style-type: none"> • The authorities should amend the law as needed to address the deficiencies in the scope of ATCA 2003 and thereby provide the required scope of coverage for STR reporting. • The FCU and supervisory authorities should take steps to enhance the timeliness of reporting of suspicious transactions to the FCU, including for suspicions of FT. • The law should be amended to provide comprehensively that suspicious attempted transactions must be reported promptly to the FCU.
<p>Internal controls, compliance, audit and foreign branches</p> <p>R.15 LC</p> <p>R.22 C</p>	<ul style="list-style-type: none"> • The authorities should supplement current provisions by introducing in law, regulation, or other enforceable means a requirement that, having regard to the size and nature of the business, financial institutions maintain an adequately resourced and independent audit function to test compliance with AML/CFT procedures.
<p>Shell banks</p> <p>R.18 C</p>	<p>none</p>
<p>The supervisory and oversight system—competent authorities and SROs : Role, functions, duties and powers (including sanctions)</p> <p>R.17 LC</p> <p>R.23 LC</p> <p>R.25 LC</p> <p>R.29 LC</p>	<p>R.17</p> <ul style="list-style-type: none"> • The FSC should consider issuing further regulations to allow it to impose additional administrative sanctions, where warranted. <p>R.23</p> <ul style="list-style-type: none"> • The authorities should apply AML and CFT requirements directly to any category of financial institutions not currently covered, having regard to such underlying ML and FT risks as may arise. • The FSC should proceed as planned to implement a supervisory regime for money-services businesses, including bureaux de change, as soon as possible. <p>R.29</p> <ul style="list-style-type: none"> • The FSC and IPA should make more frequent and extensive use of their powers to conduct AML/CFT on-site inspections of banks and insurance businesses, respectively.
<p>Money and value transfer services</p> <p>SR.VI LC</p>	<ul style="list-style-type: none"> • The FSC should proceed at an early date to conduct AML/CFT supervision of MVT service providers. • The authorities should implement ongoing measures to identify any informal MVT service providers in the IOM. • The authorities should consider reducing significantly the current EUR 15,000 threshold for the application of CDD measures to one-off transactions by MVT service providers.
<p>Preventive Measures: Non-Financial Businesses and Professions</p>	
<p>Customer due diligence and record-keeping</p> <p>R.12 PC</p>	<ul style="list-style-type: none"> • The authorities should keep under review the list of categories of higher-risk customers and consider including additional categories on a risk-related basis. • The authorities should conduct a risk-based review of the current scope of the Acceptable Applicant facility and, if warranted, limit its availability for consistency with the FATF Recommendations. • In the case of CSPs and TSPs, if the exceptions to the CDD requirements of secondary legislation as currently set out in the FSC Handbook are to be retained, the authorities should amend the secondary legislation as necessary to provide for them. • The authorities should review on a risk basis the implementation of the concession allowing operations to commence prior to completion of full

	<p>CDD procedures to ensure it is not being misused, particularly in the case of advocates.</p> <ul style="list-style-type: none"> • The DHA should proceed as quickly as possible with the planned arrangements to ensure that effective AML/CFT arrangements are place for accountancy professionals, including on a risk-sensitive basis those that are not members of either of the two main bodies. • The DHA should proceed as soon as possible with the planned implementation on a risk-sensitive basis of AML/CFT measures for dealers in high-value goods engaged in cash transactions. • The requirement to consider filing an STR if unable to adequately complete CDD measures should be extended to casinos.
<p>Suspicious transaction reporting</p> <p>R.16 PC</p>	<ul style="list-style-type: none"> • Clarify the position of legal privilege in relation to ML and FT issues and STR reporting in a manner supportive of the AML/CFT system. • The authorities should continue their efforts, through awareness raising and otherwise, to increase the effectiveness of STR reporting by DNFBPs, particularly for those categories that rarely report suspicions. • The authorities should amend the law to extend the protection for persons reporting suspicions to the FIU to cover all aspects in the international standard and limit the protection to reporting in good faith. • The authorities should consider introducing measures to ensure the confidentiality, including in Court proceedings, of persons reporting suspicions to the FIU. • The authorities should introduce a requirement in law, regulation, or other enforceable means to maintain an adequately resourced and independent audit function to test compliance with AML/CFT procedures in line with the nature, size and activity of the DNFBP. • The authorities should amend the law to require the reporting of suspicious attempted transactions.
<p>Regulation, supervision, monitoring, and sanctions</p> <p>R.17 LC</p> <p>R.24 PC</p>	<p>The authorities should:</p> <ul style="list-style-type: none"> • Provide for and implement a system of regular and full audits for advocates based on onsite visits to monitor more closely the level of compliance with their AML/CFT obligations. • Ensure that registered legal practitioners are supervised to ensure their compliance with the provisions of the AML Code 2008. • Finalize the agreement between the DHA and the professional accounting bodies, issue guidance adapted to the IOM's AML/CFT requirements, and implement an AML/CFT on-site supervisory regime for the industry. • Formalize the basis for on-site assessments for DNFBPs that do not fall within the mandate of the FSC, GSC, or the IOM Law Society. • Proceed with planned legislative amendments to provide the DHA with adequate powers in undertaking registration and regulation for AML/CFT purposes of DNFBPs within its mandate and provide the DHA with resources consistent with that mandate. • Assess the adequacy of the GSC's staffing capacity and specialist skills base to ensure it is well positioned from an AML/CFT perspective to deal with the expected growth in on-line and terrestrial casino business.
<p>Other DNFBPs</p> <p>R.20 LC</p>	<ul style="list-style-type: none"> • The authorities should proceed with their program of awareness-raising to determine what categories of NFBP should be within the scope of the AML/CFT requirements.
Legal Persons and Arrangements & Nonprofit Organizations	
Legal Persons and Arrangements: Access to	<ul style="list-style-type: none"> • The authorities should seek to put in place measures to ensure that

beneficial ownership and control information R.33 LC R.34 LC	<p>accurate, complete, and current beneficial ownership information is available for all 1931 Companies and LLCs and for legal arrangements administered by a trustee who is not covered by the licensing requirements of FSA 2008.</p> <ul style="list-style-type: none"> • The authorities should consider extending the formal monitoring of all trust and corporate service providers for compliance with the requirements of the AML Code 2008 to include those “exempted” or “excluded” from the licensing requirements of the FSA 2008.
Nonprofit organizations SR.VIII LC	<ul style="list-style-type: none"> • The authorities should complete the current review of the Nonprofit Organization (NPO) laws and regulations and consider, based on an FT risk assessment, the merits of expanding the current coverage of charities to include other NPOs. • The authorities should conduct periodic vulnerability reviews and outreach to the NPO sector regarding the risk of abuse for FT purposes.
National & International Cooperation	
National Cooperation and Coordination R.31 C	none
The Conventions and UN Special Resolutions R.35 PC SR.I PC	<ul style="list-style-type: none"> • IOM should request extension to it of the Palermo Convention. • The authorities should ensure that all provisions of the Palermo and Vienna Conventions are fully implemented. • The authorities should ensure that all provisions of the United Nations International Convention for the Suppression of Financing of Terrorism are implemented.
Mutual Legal Assistance & Extradition R.36 C R.37 C R.38 PC R.39 LC SR.V PC	<ul style="list-style-type: none"> • Amend the law to correct the deficiencies affecting the criminalization of ML and FT offenses, and thus facilitate full compliance with MLA requests related to seizure and confiscation and remove obstacles to complying with extradition requests where the dual criminality principle applies. • Remove the current restriction limiting MLA involving coercive conservatory and recovery matters to ‘designated countries’. • In amending the law in respect of the equivalent value confiscation and seizure in FT matters, remove also obstacles to related international mutual assistance.
Other Forms of Cooperation R.40 C	none
Other relevant AML/CFT measures or issues	
Resources and Statistics R.30 LC R.32 LC	<ul style="list-style-type: none"> • Consideration should be given to assigning some additional resources to AML/CFT supervision of banks and insurance businesses, particularly to allow for an increase in on-site inspections. • Some additional resources needed by the GSC and DHA. • The authorities should take steps to maintain comprehensive statistics on seizures and confiscations.

Authorities’ response

135. the IOM authorities would like to thank the evaluators for the significant amount of time and resources which were devoted to preparing a comprehensive and constructive report. The discussions held as part of the evaluation allowed the assessors time also to

understand how the different provisions are enforced, and this has contributed to a useful guide on how AML/CFT measures can continue to be improved.

136. The island is fully committed to the Recommendations of the FATF on the prevention of ML and FT. This commitment underpins the island's regulatory regime and, we believe, has nurtured a culture of compliance throughout the jurisdiction.

137. When the Proceeds of Crime Act 2008 (POCA 2008) came into operation on October 22, 2008, the report notes that not all of the legislation was brought into force at that time. POCA 2008 amalgamated drugs and all-crimes AML legislation and makes changes to the offences relating to STRs. The remainder of the legislation has now come fully into force on August 1, 2009.

138. During 2009 a new Terrorism (Finance) Act 2009 completed its passage through Tynwald, and is now in force. This legislation provides the Treasury with powers to issue directions to individuals or companies to enhance CDD, monitoring or systematic reporting. It mirrors parts of the U.K.'s Counter Terrorism Act which came into effect in November 2008. The Terrorism (Finance) Act 2009 allows the IOM authorities to compile its own list of suspects subject to sanctions when required, such as if FATF advises measures against a country because of concerns regarding the financing of terrorism. It will also provide a new, local appeal mechanism for those subject to UN terrorism or Al-Qaida and the Taliban sanctions.

139. During 2009, work has been ongoing to develop an Anti-Terrorism and Crime (Amendment) Bill 2009, which is intended to further enhance the IOM's counter terrorism legislation in line with developing international standards.

140. The Island's Criminal Justice (ML) Code 2008 will continue to be reviewed and revised where necessary.

141. The island continues to place a very high priority on cooperation with regulators and law enforcement authorities in other jurisdictions, and in relation to taxation matters it continues to commit to TIEAs as it develops closer economic and taxation cooperation with other countries.

Appendix I. Implementation of the Recommendations of the 2003 Assessment

Table 18. Implementation of 2003 Recommendations to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action	Action Taken
CP 1(2) – Operational independence and adequate resources	<p>The existing framework of government dependence and the lack of budgetary autonomy should be addressed.</p> <p>Perform an in-depth analysis of the resources required to fulfill the supervisory objectives and as a consequence establish a change plan for the business process of banking supervision.</p>	<p>The FSA 2008 contains provisions to strengthen the independence of the FSC, for example, by making Tynwald members ineligible to be members of the commission. In practice, the FSC has considerable independence, but the budget is still decided by government.</p> <p>The FSC considers that it has broadly adequate resources for current banking supervision tasks.</p>
CP 16 - On-site and off-site supervision	<p>Prioritize the completion of the examination methodology for full scope examinations supplemented by formalized quality control procedures.</p> <p>Explore increased synergies between FSC and external auditors.</p>	<p>The FSC has well-developed procedures for on- and off-site supervision, and makes frequent on-site inspections to review the general situation of banks and specific issues.</p> <p>The FSC receives copies of auditors' management letters and certain compliance certificates. It may also require banks to appoint reporting accountants but in practice does so only infrequently. It does not delegate supervisory responsibility to auditors.</p>

Table 19. Implementation of 2003 Recommendations to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action	Action Taken
Organization of an Insurance Supervisor i.e., CP 1	Steps should be taken to ensure that the IPA is distanced from any possible political influence. The board should not have any representation from Tynwald. The proposed Amendment bill should be reviewed in the light of this assessment to ensure that any outstanding issues are dealt with.	The IA 2008 contains provisions to strengthen the independence of the IPA, for example, by requiring Board members to have appropriate qualifications. No Tynwald member is a member of the board now. In practice, the IPA has considerable independence. But the budget is still decided by government; Tynwald may annul new IPA Regulations and Board members may be dismissed by the Council of Ministers without there being a requirement for reasons to be published.
Corporate Governance and Internal Controls i.e., CPs 4–5	This principle should be fully recognized within the legislation by way of development of appropriate regulations.	The IPA has increased its focus on these issues in its supervision work but still lacks standards in relation to corporate governance and internal controls. New binding guidance in these and related areas is expected to take effect in Q1 2009.
Prudential Rules i.e., CPs 6–10	The on-site inspection procedures should be carefully reviewed to ensure that all the appropriate checks are covered. The reporting requirements under the existing regulations should be expanded to take the principle fully into account.	The procedures for on-site work have been substantially revised and extended. Reporting requirements have been expanded and now enable the IPA to monitor reserving adequacy and compliance with solvency requirements.
Market Conduct i.e., CP 11	Consideration should be given to bringing all intermediaries within the scope of the act.	The IPA continues to have responsibilities for general insurance intermediaries, while the FSC covers intermediaries for life insurance. While there remain arguments for bringing all intermediaries within one act, most life insurance intermediation is carried out as part of wider investment advisory business.
Monitoring, Inspection, and Sanctions i.e., CPs 12–14	Staff resources should be carefully monitored as these programs are developed.	Staff resources—and the depth and range of available skills—have been reviewed and increased where necessary. It remains important that IPA keep overall resources under review.

Table 20. Implementation of 2003 Recommendations to Improve Observance of IOSCO Principles

Reference principle	Recommended Action	Action Taken
Principle 2—All countries/ jurisdictions should require those individuals holding key positions in a trust or company service provider (key persons) should be fit and proper	<p>The FSC should ensure that the July 31 deadline for completion of the licensing process for CSPs is met.</p> <p>The IOM should also enact quickly the Fiduciary Services Bill to extend the regulatory and supervisory regime to TSPs.</p>	<p>CSPs are now all licensed. "Fit and proper" rules are applied to all CSPs.</p> <p>The Fiduciary Services Act (2005) extended the regulatory and supervisory regime to TSPs, and that act has now been consolidated and replaced by the FSA 2008. "Fit and proper" rules are applied to TSPs.</p>
Principle 3—All countries/jurisdictions should require that those providing the service of trust or company service provider exhibit evidence that their business will be or is being conducted in accordance with the proper corporate governance, customer due diligence, conduct of client business, financial soundness and systems and controls requirements	Same as above.	Besides the legislative changes described above, extensive regulations on corporate governance, CDD, conduct of client business, financial soundness, and controls have been issued for CSPs and TSPs. The FSC monitors compliance with these regulations through reporting requirements and on-site inspections.

Appendix II. Stress Testing Methodology and Shocks

142. **The tests included bottom-up analyses performed by Manx banks and insurance companies using their in-house risk management systems, as well as top-down analyses performed by the FSC in collaboration with the mission.** Since many banks have limited independent treasury management functions, the tests were often performed by or in close collaboration with the parent bank. The exercise covered over 80 percent of the relevant financial institutions (by market share), and used end-June 2008 data, where available. It focused on local institutions and subsidiaries of foreign parents, except in the case of liquidity tests, which included in addition four branches.

Banks

143. **The stress tests assessed the sensitivity of banks to single factor shocks to interest rates, exchange rates, credit quality, and liquidity.** The single factor tests were calibrated in line with those used in recent FSAP Updates for EU and other mature market countries, particularly the UK, and accounted for larger shocks experienced during recent global financial turmoil. The interest rate shocks included 200 basis point parallel upward and downward shifts of the sterling, dollar and euro yield curve. The exchange rate shock focused on the impact of a 20 percent depreciation of the dollar and the pound Sterling. The credit risk tests analyzed banks' resilience to the default of their three largest exposures (net of claims to parent banks) and various other components of their credit portfolio. Liquidity tests were performed to assess the resilience of the banking system to a daily withdrawal of liabilities without access to external funding, including from parent banks.¹⁸ Given the nature of banks' business and the limited domestic macroeconomic impact on the financial sector, more elaborate scenario tests or more extreme single factor tests are not worthwhile.

144. **The results (See Table 9), are expressed in terms of two measures:** (i) the average percentage point change from the pre-shock capital (the starting point is shown in the first row), with the minimum and maximum percentage change across banks (Columns 1–3); and (ii) the average income loss/gain in percent of pre-shock capital, with the minimum and maximum percent change across banks (Columns 4–6). The first six columns refer to the bottom-up approach, whereas the remaining six columns refer to the top-down approach. Overall, both approaches produce similar results, although the top-down results tend to be less robust, due to supervisors less detailed knowledge of the banks' collateral and guarantees, some of which are managed at group-level.

¹⁸ The test assumed a daily drawdown of liabilities on demand (including fiduciary deposits) and due within one month by 30 percent over 30, 60, and 90 days.

Insurance

145. **Similar stress tests were conducted for the key insurance companies.** Insurance sector business is limited in scope, but there are vulnerabilities in risk and capital management and potentially exposure to reinsurers. The interest risk and foreign exchange rate tests focused on single-factor shocks to the sterling pound yield curve, as insurance companies have limited exposure to other key currencies. To capture the exposure of insurance companies to real estate, the credit risk tests included a 20 percent real estate price decline. Resilience to insurance risks (specifically, a 25 percent permanent increase in mortality and morbidity, as well as a permanent 25 percent reduction in annuitant mortality across all current and deferred annuitants, i.e., increased longevity) is also assessed.

146. **The results (See Table 10) are expressed in terms of:** (i) the post-shock coverage ratio (where 100 percent means that net admissible assets match the minimum reserve requirements) (Column 1); and (ii) the average percentage point change from the pre-shock coverage ratio, with the minimum and maximum percentage point change across insurers (Columns 2–4).