



## **FINANCIAL SERVICES (MISCELLANEOUS AMENDMENTS) BILL 2012**

### **EXPLANATORY NOTES**

*These notes are circulated for the information of Members with the approval of the Member in charge of the Bill, the Minister for the Treasury, Hon. W. E. Teare MHK.*

#### **1. INTRODUCTION**

- 1.1 These explanatory notes relate to the Financial Services (Miscellaneous Amendments) Bill 2012. The Bill is promoted by the Treasury on behalf of the Financial Supervision Commission ("the Commission"). The notes have been prepared by the Commission in order to assist readers of the Bill. They do not form part of the Bill and have not been endorsed by the House of Keys.
- 1.2 The notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill.

#### **2. BACKGROUND**

- 2.1 This Bill, which is promoted by the Treasury on behalf of the Commission, contains amendments to the Financial Services Act 2008 ("FSA 2008") and the Collective Investment Schemes Act 2008 ("CISA 2008"), which together provide for the supervision and regulation of financial activities by the Commission.
- 2.2 FSA 2008 and CISA 2008 consolidated and replaced laws including the Banking Act 1998, Investment Business Act 1991 and Corporate Services Providers Acts 2000 – 2005. FSA 2008 establishes the Commission's role, specifies its financial services functions and confers powers and duties to regulate certain financial services and activities. CISA 2008 deals with the collective investment schemes (also known as funds) and how those schemes may be arranged and operated.
- 2.3 The amendments proposed by the Bill reflect evolving international standards in financial regulation; improve consistency between the two Acts; and revise powers relating to lack of fitness and propriety. Some changes result from comments made by assessors from the International Monetary Fund ("IMF") following their last visit to the Island; other changes reflect industry comments or clarify existing

provisions. The Bill also makes a minor consequential change to the Companies Act 1931.

- 2.4 The Bill has been the subject of wide consultation and all comments have been addressed. There is no indication that the Bill will place any additional administrative or financial burden on the regulated sectors or on Government. Some clauses are designed to reduce administrative burdens on the Commission.
- 2.5 It is anticipated that all clauses of the Bill will come into operation soon after Royal Assent. All new powers to make secondary legislation inserted into FSA 2008 and CISA 2008 by the Bill, require those orders or regulations to be subject to approval by Tynwald.
- 2.6 The Bill is considered to be compliant with the Human Rights Act 2001.

### **3. STRUCTURE OF THE BILL**

The Bill is structured as follows -

- 3.1 **Part 1** of the Bill is introductory, providing for the short title, commencement and interpretation.
- 3.2 **Part 2** (*clauses 4 to 25 and the Schedule*) amends FSA 2008 by introducing enabling powers for the transfer of deposit-taking business; amending fitness and propriety provisions; and clarifying various meanings. Part 2 also varies some appeals provisions and reporting requirements; enhances information-gathering powers; and specifies certain factors to be considered by the Commission. In addition, Part 2 makes an amendment to the Ombudsman Scheme compensation limit, incorporates two existing gateways into FSA 2008 and provides powers for adding new gateways to the Act.
- 3.3 **Part 3** (*clauses 26 to 34*) amends CISA 2008 by replicating in that Act the fitness and propriety powers in FSA 2008 (existing and proposed), namely warnings notices, directions and prohibitions (with appeal provisions). Also in line with FSA 2008, Part 3 introduces civil penalties' powers and provides for the Commission to vary certain reporting requirements. Additionally, Part 3 enables the Commission to vary certain requirements for Authorised and Recognised Schemes.
- 3.4 **Part 4** (*clauses 35 and 36*) provides the closing provisions. It makes a consequential amendment to the Companies Act 1931; repeals a sub-section of FSA 2008 in consequence of a change in Part 2; and revokes three Orders connected to gateway and Ombudsman provisions in Part 2.
- 3.5 **The Schedule** relates to clause 5. It adds a new Schedule 1A to FSA 2008, in accordance with the new section 3A in that Act, so as to enable the transfer of deposit-taking business.

## **4. CLAUSE BY CLAUSE NOTES**

### **4.1 Part 1**

4.1.1 **Clauses 1 and 2** provide for the short title and commencement only. The Bill will come into operation on day(s) specified in order(s) made by Treasury.

4.1.2 **Clause 3** provides interpretation of the abbreviated references to CISA 2008 and FSA 2008.

### **4.2 Part 2 – Amendment of FSA 2008**

4.2.1 **Clause 4** introduces the amendments.

4.2.2 **Clause 5** adds a new section 3A and Schedule to FSA 2008 to enable the Commission to approve the transfer of deposit-taking business from one licensed deposit-taker to another, in response to a request from industry. This will replace the current need for deposit-takers to seek specific Acts of Tynwald, which is costly and time-consuming for the deposit-takers concerned. Similar powers exist in the Isle of Man's insurance legislation, as well as in Jersey's banking legislation. Suitable safeguards to protect depositors' interests are introduced via the Schedule.

4.2.3 **Clause 6** amends section 6 to impose an express requirement that key persons connected with an applicant for a licence should be fit and proper to act in that capacity and that, in considering a licence application, the Commission will also have regard to the fitness of the applicant's employees and its associated persons.

The provision will not cause the Commission to increase its current level of vetting, which will continue to be limited to key persons, but it will enable the Commission to consider its response to information on any unsuitable person associated with the licence applicant. The enhancement is designed to improve public protection.

4.2.4 **Clause 7** amends section 10 of the FSA 2008. A person who may appeal against a section 10 direction becomes an appellant rather than an applicant. Additionally, the obligation on a licenceholder not to appoint a person in contravention of a section 10 direction is strengthened. This variation emphasises a licenceholder's responsibility to verify that its controllers, directors and key persons are fit and proper before they are appointed.

Changes to section 10's fitness and propriety provisions also result in consequential changes to sections 13 and 35 of FSA 2008 in clauses 10 and 36 respectively. These consequential changes are as a result of the new provisions introduced by clause 8. One change in respect of section 10 directions will be the removal of the need to maintain a public register. The new power in clause 8 will

generally be used where public protection and publication are required. The appeal powers (in section 32) which relate to section 10 directions are widened to address variations to section 10 directions by clause 15.

- 4.2.5 **Clause 8** introduces and details the circumstances relating to a new power to enable the Commission to prohibit any individual from performing functions in relation to regulated activities. The new sections 10A to 10D specify who may be subject to a prohibition; what functions the individual may be prevented from carrying on; the process that must be used to impose a prohibition; variation and revocation procedures; and the requirement to publish a list of prohibitions.

Prohibitions will be subject to an appeal process due to new powers in section 32. There are consequential amendments to sections 13, 20 and 32, which are described in clauses 10, 13 and 15 and which relate to publication, contravention and appeal powers.

This new power may apply to any individual, in contrast to the existing section 10 direction power which may only apply to persons in “vettable” roles (directors, controllers and key persons). Sections 10A to 10D will reflect existing powers in the UK, Jersey and Guernsey and enable staff at any level to be prevented from performing functions connected with regulated activities if they have, for example, committed theft in a connected business. The new provisions aim to prohibit, where appropriate, non-vetted staff from performing functions related to a regulated activity and thereby to enhance public protection. The flexibility of the prohibitions’ provisions will enable any prohibitions to be tailored to specific situations, rather than apply bluntly to all situations, as is the case with current section 10 powers. There will be no adverse impact upon individuals who are fit and proper and no impact is expected upon any other parties.

To reflect the re-structuring of fitness and propriety sanctions in clauses 7 and 8, the section 10A prohibition will be public, whereas the section 10 direction will no longer be public.

- 4.2.6 **Clause 9** amends provisions relating to section 11 warning notices.

Firstly, it enables the Commission to issue warning notices to *former* directors, controllers and key persons (“relevant persons”) in respect of their actions when they held these roles. At present warning notices can only be applied to *current* relevant persons, but as discrepancies sometimes come to light subsequently, the change will enable *former* relevant persons to be sanctioned. The revised provision may be used, for example, in the winding up of a *former* licenceholder, or in respect of *former* relevant persons that have resigned their positions.

Secondly, the clause makes it explicit that the Commission may disclose a warning notice to a company of which a person is or may become an officer, so that the company will be aware of the Commission’s concerns regarding that person.

Thirdly, the clause removes reference to “remedial” in respect of action that must be taken by the relevant person in response to the warning notice. This change will allow action to be specified which does not necessarily remedy a particular situation, as this is not always possible, but which may, for example, reduce the likelihood of a situation recurring.

Clause 9 also includes amendments in consequence of the proposed new prohibition power which is described in clause 8. The changes provide that the Commission may take a warning notice into consideration before imposing a prohibition, but the warning notice does not limit the powers of the Commission in respect of prohibitions. The terms “notified person” and “officer” are introduced to section 11(7) for simplification purposes.

4.2.7 **Clause 10** amends section 13 concerning public statements, by clarifying the application of that section. It also incorporates powers to issue a public statement in respect of the new prohibition power described in clause 8 and, in respect of a section 10 direction, it changes the duty to issue a public statement into a power to do so.

4.2.8 **Clause 11** adds to section 14 a new sub-section (2A) which enables the Commission to vary or revoke directions issued to permitted persons under this section. The clause also requires that the Commission provides a statement of reasons for any variations.

4.2.9 **Clause 12** makes it explicit that failure to comply with the Rule Book reporting requirements may result in an action for breach under section 19.

4.2.10 **Clause 13** adds to section 20 injunction powers which may apply if a prohibition imposed under the provisions inserted by clause 8 is likely to be breached. This replicates injunctive powers which exist in respect of breaches of various other requirements, including section 10 directions.

The clause also provides that where investors or customers have suffered loss etc. as a result of a contravention of a requirement, the High Court may direct that it be remedied. This change is expected to have little impact, but recognises that clients of regulated businesses may be customers or investors.

4.2.11 **Clause 14** specifies that if a permitted person breaches a section 23 requirement to provide a specific report relating to that person’s affairs, the Commission may undertake an action for breach. Such events happen rarely, but the change will increase the Commission’s ability to protect the public against non-compliant licenceholders.

4.2.12 **Clause 15** adds to section 32 the ability for affected persons to appeal against prohibitions made under new sections 10A to 10D (per clause 8) and provides a power to appeal against variations to section 10 directions. For clarity, the clause also replaces the current list of matters in respect of which an appeal may be made with a table.

4.2.13 **Clause 16** restructures the statutory indemnity provisions of section 33 to make it clear that anyone carrying out functions for or on behalf of the Commission is covered by the Commission's statutory indemnity provisions, unless their action is in bad faith. This amends the current wording which links indemnity to exercise of functions "conferred by or under a specified enactment".

The amendment addresses situations in which the Commission carries out functions under powers delegated to it by other areas of Government (for example by the Treasury). Therefore, this is a clarification of the existing policy rather than a policy change, but it provides more certainty for officers etc. of the Commission.

4.2.14 **Clause 17** changes the heading for section 40 and amends the section by adding provisions relating to clause 12 in respect of reporting to the Commission. Clause 17 makes it an offence to fail to supply information as required, except where there is a reasonable excuse, or legal professional privilege could be maintained.

4.2.15 **Clause 18** amends section 41 by extending the offences and penalties powers to contraventions of —

(a) section 10(8) - a licenceholder's obligation not to appoint a person in contravention of a section 10 direction;

(b) section 10A(5) – an individual's obligation not to perform a prohibited function; and

(c) section 10A(6) – a permitted person's obligation not to permit an individual to perform a prohibited function.

The penalties under section 41 on summary conviction are a fine of up to £5,000, custody of up to six months, or both.

4.2.16 **Clause 19** makes a minor amendment to the section 48 (interpretation), in connection with the Foundations Act 2011, by expanding the meaning of the term "director" so as to include a member of the council of a foundation. Clause 19 also adds the imposition of a prohibition under section 10A to the definition of "action for breach", so as to reflect the powers introduced by clause 8.

4.2.17 **Clause 20** amends Schedule 1 as follows:

In paragraph 1, the grounds on which a Commissioner (of the Commission) may be removed from office are set out, following an observation by IMF assessors that Tynwald is not required to make public its reasons for removing a Commissioner from office.

A revision to paragraph 3 responds to a comment from IMF assessors concerning the Commission's lack of explicit mandate to promote the stability of the financial system. The amendment requires that the Commission consider financial stability in discharging its functions. This policy change is expected to assist the Commission to support the Island's economy and its development as an international finance sector, as well as to reduce financial crime where this may threaten stability.

Paragraph 4 addresses a comment from IMF assessors that the boundaries of Treasury's powers to specify policies and strategies to the Commission are not explicitly defined in legislation. This amendment therefore clarifies the Treasury's powers to issue guidance and directions to the Commission. In consequence, the heading of this paragraph is changed to reflect its content.

4.2.18 **Clause 21** amends Schedule 2 as follows:

In paragraph 1, the Commission's powers are clarified and enhanced to reflect its existing role in approving and registering auditors of "market-traded companies", (per EU Directive 2006/43/EC). The clause adds a power for the Commission to inspect and investigate current and former "Recognised Auditors" in respect of their audits of market-traded companies. The clause also adds to paragraph 1 definitions of four terms that relate to this activity and a power for the Treasury to amend these definitions by order in case of need. Recognised auditors are a specific group of auditors who register with the Commission in order to carry out specific audits in line with EU standards.

Paragraph 2 addresses an IMF comment that the regulator should be able to review the perimeter of regulation regularly. The amendment enhances the Commission's powers to seek information from unregulated entities and thereby facilitates the Commission's ability to keep abreast of changes in the financial sector, in order to help it detect and prevent abuse of the financial system. The change is not expected to impact upon the regulated sector or those wishing to carry on licensed activity.

4.2.19 **Clause 22** amends Schedule 3 by replacing the requirement for certain matters to be specified in the Rule Book (paragraph 1(1)(u) and (w)), by an ability for the Commission to specify requirements in such other manner as it thinks fit, subject to those requirements being drawn to the attention of affected parties. The Rule Book is secondary legislation made under the FSA 2008. The change is expected to assist licenceholders and the Commission.

4.2.20 **Clause 23** amends Schedule 4 which relates to the Financial Services Ombudsman Scheme, as operated by the Isle of Man Office of Fair Trading. The changes reflect variations to the maximum levels of compensation that may be awarded by adjudicators and provide a power for the Treasury to vary this sum by order in future.

4.2.21 **Clause 24** adds to Schedule 5 the two existing gateways (which permit the transfer of information between the Commission and other organisations) that are currently shown in orders made under FSA 2008. Including gateways in the Act increases transparency and enables them to be found more easily, primarily by external reviewers. Consequential on this change, clause 36 will revoke the existing gateways orders.

The clause also lists in a new sub-paragraph 2(1A), the enactments to which one of these gateways relates and provides in new sub-paragraph 2(1B) that the Treasury may amend this list by order.

4.2.22 **Clause 25** amends terminology in various sections of FSA 2008 from “is in contravention of” to “contravenes” for improved clarity. No change in meaning is intended by the change.

### **4.3 Part 3 - Amendment of CISA 2008**

4.3.1 **Clause 26** introduces the amendments.

4.3.2 **Clause 27** amends the heading to Part 5.

4.3.3 **Clause 28** amends section 11 which provides when the Commission may exercise its powers under Part 5 (Oversight and Intervention) of CISA 2008 and changes the section’s heading as a result. This change is a consequence of the new sections 11A to 11F, as described in clause 29.

4.3.4 **Clause 29** adds new sections 11A to 11F to CISA 2008 to address lack of fitness and propriety in members of collective investment schemes’ governing bodies. These powers replicate those in, or proposed for, FSA 2008, so as to ensure equal treatment for those subject to either of the Acts.

Specifically, the new sections add to CISA 2008 powers to issue directions that a person is not fit and proper; give warning notices; and impose prohibitions on members of collective investment schemes’ governing bodies. These changes will provide powers to sanction those holding key roles in relation to schemes (also known as funds). The changes widen the application of an existing policy, but only impact on members of schemes’ governing bodies. The new sections are designed to enhance public protection by enabling the Commission to impose sanctions upon those persons who demonstrate lack of competence, solvency or integrity.

The Commission’s use of the new powers in sections 11A to 11F (directions, prohibitions and warning notices) may be appealed against under new provisions in section 21 – see clause 31.

4.3.5 **Clause 30** introduces the power to impose civil penalties in CISA 2008, as this Act currently contains none, for failure to comply with legislative requirements. The new section 19A will enable the Commission to apply equivalent treatment to functionaries of schemes (under CISA 2008) as to licenceholders (under FSA 2008), for example for failure to submit reports on time.

There is no intention to impose penalties upon scheme functionaries (under CISA 2008) for a wider range of issues than for other financial services businesses (under FSA 2008). Penalties may be imposed, for example, for failings relating to administering or managing collective investment schemes and as such, this change is only expected to impact upon scheme administrators and scheme managers. The penalties' powers aim to deter poor management and administration and will be subject to appeal provisions under new powers in section 21 – see clause 31.

4.3.6 **Clause 31** amends section 21 by adding powers to appeal against the Commission's decisions in relation to the new provisions in clauses 29 and 30 (sections 11A-11F and section 19A). As in clause 15 (which amends FSA 2008), for improved clarity, clause 31 substitutes a tabular format for the current list of matters in respect of which an appeal may be made.

4.3.7 **Clause 32** adds a new section A24 relating to the form and content of information. This change is in line with the change proposed to FSA 2008 by clause 22, and allows the Commission to determine the form and content of any document or information to be submitted to it and the manner in which it is to be delivered. The clause requires the Commission to draw such determinations to the attention of those likely to be affected by them. This is to reduce the regulatory burden under the Act.

4.3.8 **Clause 33** amends Schedule 1 of CISA 2008 which relates to Authorised Schemes. The amendment will allow the Commission to vary the requirements for Authorised Schemes by order and reflects the power already in place for International Schemes (in Schedule 2). The amendment mitigates the risk that the current lack of flexibility may hinder the future development of the Authorised Schemes industry in the Island.

4.3.9 **Clause 34** amends Schedule 4 which relates to Recognised Schemes. The Schedule currently requires the Commission to issue a "notice in writing" to require certain standard information from Recognised Schemes' governing bodies. The change will allow the Commission to make regulations instead to address the standard information that governing bodies are required to publish to potential investors. The Commission will still need to issue notices in writing to require non-standard information.

The clause also clarifies that it is the jurisdiction in which a Recognised Scheme is authorised that is important, not where it is managed.

4.3.10 **Clause 35** makes a consequential amendment to the Companies Act 1931 in respect of the transfer of deposit-taking business provisions contained in clause 5 and in the Schedule to this Bill.

4.3.11 **Clause 36** repeals section 35(2) of FSA 2008 which requires the Commission to keep a register of directions issued under section 10, so as to reflect the changes to fitness and propriety provisions contained in clauses 7 and 8 of this Bill.

Clause 36 also revokes the two gateways orders that are moved to FSA 2008 by clause 24, as well as the Ombudsman Scheme compensation order that is made redundant by clause 23 of this Bill.

4.3.12 The **Schedule** is enabled by clause 5 (new section 3A of FSA 2008) and contains the provisions relating to the transfer of deposit-taking business. The paragraphs describe relevant transfer schemes; the application to transfer schemes of any compromises or arrangements in respect of sections 152 to 154 of the Companies Act 1931; how applications for transfer schemes may be made; how any requirements may be imposed on applications; who may be heard in respect of an application; and conditions that must be satisfied before the High Court may sanction a transfer scheme.

This change was requested by industry, for whom it is likely to provide a significant cost-saving when any such transfers occur.