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OFFSHORE FINANCIAL SECTOR ASSESSMENT UPDATE

PRINCIPALITY OF MONACO

TECHNICAL NOTE

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION—UPDATE

JUNE 2008

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

AMAF	Association Monégasque des Activités Financières (Monegasque Association of Financial Activities)
AMF	Autorité des Marchés Financiers (French Financial Market Authority)
CB	Commission Bancaire (French Banking Commission)
CBFA	Commission Bancaire, Financière, et des Assurances (Belgian financial sector regulator)
CCAF	Commission de Contrôle des Activités Financières (Financial Activity Supervisory Commission)
CESR	Committee of European Securities Regulators
CIS	Collective investment scheme
COB	Commission des Opérations de Bourse (the predecessor body to the AMF)
CONSOB	Commissione Nazionale per le Società e la Borsa (Italian securities market regulator)
CSSF	Commission de Surveillance du Secteur Financier (Luxemburg financial sector regulator)
DEE	Direction de l'Expansion Economique (Division of Economic Expansion)
EU	European Union
IOSCO	International Organization of Securities Commissions
MAD	Market Abuse Directive
MO	Ministerial Order
MoU	Memorandum of Understanding
MMoU	Multilateral Memorandum of Understanding
OEC	Ordre des Experts Comptables (Monegasque Association of Chartered Accountants)
OECD	Organization for Economic Cooperation and Development
SICCFIN	Service d'Information et de Contrôle sur les Circuits Financiers (Monegasque Financial Intelligence Unit)
SO	Sovereign Order
UCITS	Undertakings for Collective Investment in Transferable Securities

IOSCO OBJECTIVE AND PRINCIPLES OF SECURITIES REGULATION—UPDATE[1]

I. CONCLUSIONS AND RECOMMENDATIONS OF THE 2003 ASSESSMENT

1. The International Organization of Securities Commissions (IOSCO) Objectives and Principles were first published in 1998, and assessments of individual jurisdictions began at that time based on a four fold categorization; implemented, partly implemented, not implemented and not applicable. A formal methodology to provide a more uniform structure to the assessment process, based on responses to key questions, was introduced only in October 2003. The original assessment took place in April/May 2002 and was updated in May 2003. The 2008 update has regard to those key questions although it does not seek to re-benchmark the jurisdiction based on answers to them.

2. As regards the 30 Principles the 2003 assessment concluded the following:

Table 1. Monaco: 2003 IOSCO Assessment

Classification	Total	Principles
Implemented	13	4,5,8,9,10,13,16,18,19,20,21,22,23
Partially implemented	7	1,2,3,11,12,17,24
Not implemented	0	
Not applicable	10	6,7,14,15,25,26,27,28,29,30

3. The IMF has recently published a staff analysis of the results of the more than 70 assessments conducted since 1998 and graded results by several measures including income level of the jurisdiction and whether a jurisdiction is a member of the Organization for Economic Co-operation and Development (OECD).[2] Monaco scored 65 percent on applicable Principles rated implemented or broadly implemented.[3] High income members of the OECD scored an average of 85 percent although countries with a high income but outside

[1] The principal author of the assessment was Mr. Richard Britton (IMF consultant on securities market regulation).

[2] Carvajal, Ana and Elliott, Jennifer (2007) "Strengths and Weaknesses in Securities Market Regulation: a Global Analysis," IMF Working Paper No. 07/259, November.

[3] The grade of "broadly implemented" was introduced by IOSCO in 2002 and not used in the Monaco assessment; this complicates the use of data comparing grades.

the OECD scored an average of only 74 percent. Significant shortfalls in the Monaco assessment were identified in principles concerning the regulator (40 percent vs. 85 percent in high income OECD members) and in cooperation (33 percent vs. 79 percent in high income OECD members). Furthermore it is arguable whether the conclusion that Principle 28 (Regulation should be designed to detect and deter manipulation and other unfair trading practices) was not applicable was a valid conclusion. If it had been assessed it is highly unlikely that it would have been rated as implemented.

II. Principles Review

4. Overall there has been progress in implementing the Offshore Financial Center assessment recommendations in most areas of securities regulation but more needs to be done on key topics.

The regulator: Principles 1–5

5. Principles 1, 2 and 3 were assessed as partly implemented. At that time investment activities were regulated by two Commissions. One was responsible for mutual funds and one was responsible for other portfolio management activities. In both cases their role was an advisory one to the Minister of State. The decision to combine the two Commissions into one, the Commission de Contrôle des Activités Financières (CCAF), in 2007, as recommended in the assessment, has removed concerns about inefficient structures and legal constraints on the exchange of information between the two Commissions. The enabling legislation, Act 1.338 (September 7, 2007), and the parallel legislation updating the mutual fund and investment fund regimes Act 1.339 (September 7, 2007) have also provided an opportunity for dealing with several other recommendations in the 2003 assessment.

6. The CCAF has been made a licensing authority, as recommended in the 2003 assessment. It is empowered to grant a license to a firm to engage in the investment activities set out in Article 1 Act 1.338 and to issue a notice of authorization to a mutual fund (Article 2 Act 1.339). The license is necessary to carry out the activities and without the notice of authorization the constitution of the mutual fund is void.

7. In granting a license to conduct investment activities the CCAF considers the professional qualifications of individuals, the company's systems and controls and its sources of capital. However, Monaco has retained its policy of requiring the authorization to carry on all types of commercial activity including the provision of banking and investment services to be provided by the Direction de l'Expansion Economique (DEE). With the assistance of the Monegasque police the DEE carries out checks on the background of applicants for a license such as whether the applicant has a criminal record, has been adjudged bankrupt, etc. In the case of banking and investment services most of these enquiries involve liaison with overseas regulators and other agencies. Without authorization from the DEE a license issued

by the CCAF is invalid. Similarly, if the DEE was to withdraw an authorization the bank or investment manager would have to cease business. This division of responsibility for performing the totality of the "fit and proper checks" on a bank or investment firm is transparent and appears to work satisfactorily.

8. Recommendations on the transparency of regulatory decision making have been dealt with by Article 9 of Act 1.338 which requires the CCAF to publish a notice that a license has been issued in the Journal de Monaco. Decisions ordering the suspension or revocation of a license must also be published in the Journal. Equivalent provisions apply to mutual funds under Article 2 of Act 1.339. The CCAF's decisions are considered as administrative acts under the terms of Act 1.312 (June 29, 2006) and therefore grounds for the decisions of withdrawal or refusal of a license (and other acts such as the imposition of sanctions) must be notified to the companies' managers or to the mutual funds' founders. The DEE is under the same obligation. Decisions of the CCAF and the DEE are subject to appeal by the parties subject to the decision.

Other recommendations for action

9. Conflicts of interest: The 2003 assessment recommended that conflicts of interest policies should be adopted for Commission members and staff (including reporting of trades) along with monitoring of compliance. The Authorities note that Act 1.338 and its associated Sovereign Order (SO) 1.284 impose certain restrictions on members of the Commission which address some of the issues raised.[4] However, there is no code of conduct governing such issues as staff holding and trading of securities subject to the jurisdiction of the Commission nor measures to investigate allegations and sanction abuse. It should be noted that under the Methodology devised by IOSCO to assess compliance with the Principles in October 2003 such omissions would merit an assessment of "not implemented" for Principle 5. The 2003 recommendation is repeated here.

10. Immunity from law suit: It was recommended that Commission members should be protected from liability while carrying out duties in good faith—staff is protected by virtue of their status as civil servants. Such a provision is viewed as an important to ensure that in making decisions as to, for example, administrative sanctions, Commissioners are not

[4] Neither the President of the Association Monégasque des Activités Financières (AMAF—Monegasque Association of Financial Activities) nor the President of the Odre des Experts Comptable (OEC—Order of Chartered Accountants), both of whom are members of the Commission by virtue of their roles, may be appointed Chairman of the Commission; the latter may not express an opinion regarding a company or mutual fund subject to Commission oversight if he is its auditor or accountant; and no member of the Commission may express an opinion if he/she is a shareholder, director or employee of a company subject to Commission oversight.

exposed to pressure from parties under investigation. This recommendation has not been adopted. It is repeated here.

11. Power to remove Commission members: It was recommended that the criteria by which the Government might legitimately remove a member of the Commission (such as a criminal conviction, serious illness, etc.) be set out in law. Such a provision is seen as important in preserving the independence of Commissioners free from political pressure. This recommendation has not been adopted. It is repeated here.

12. Legislative and regulatory development: It was noted in 2003 that the role of the Commissions was purely advisory and all licensing decisions and regulatory development were the preserve of the government. This remains the case with the latter although the process by which legislation and secondary regulatory measures are formulated and finalized is more transparent. The public as well as professional market participants are able to see drafts in advance and comment via their members of parliament. Furthermore the CCAF is developing informal processes to secure high standards in areas such as investment mandates. It builds on the law (Acts, Sovereign Orders and Ministerial Orders) which is generally drafted at a high level of generality. This is consistent with Europe's "better regulation" agenda and its goal (not always fulfilled in practice) of relying more on "principles based" regulation and the imposition of more responsibility on the senior management of investment firms. It will be important in preserving confidence in the process that it be based on consistent standards consistently, and transparently, applied.

Other issues

13. Independence of the Commission: The 2003 assessment noted that the two Commissions were not independent of government. But it also noted that in this small financial community where the government exerts extensive control over all forms of commercial activity it was not clear that full independence as strongly recommended by IOSCO is achievable. In practice progress towards a fully independent regulator has been made. The CCAF is an independent licensing authority; it has powers to administer administrative sanctions. The CCAF has relocated to its own downtown offices, a symbolic move perhaps but not insignificant in a financial community of this size. The independence of the CCAF is set out in A10 Act 1.338 and A23 SO 1.284. It is thus significantly more independent than its predecessors. However, the power to make regulations remain with the Ministry of State, as administrator of all laws in the Principality. In this regard the CCAF remains in an advisory position although it is developing a significant role in transposing Acts, Sovereign and Ministerial Orders into practical compliance measures. One outstanding issue concerns the Commissaire du Gouvernement who is mandated to attend Commission meetings in an advisory capacity which may give the government an opportunity to influence CCAF operational decisions. It is recommended that in due course, when the CCAF has had

an opportunity to gain experience and reputation as the Monegasque regulator, the presence of the Commissaire du Gouvernement should no longer be mandated at Commission meetings particularly when decisions on operational matters such as licensing and administrative sanctions are to be taken.

14. Commission staffing: The Commission operates with a very small staff which may not be sufficient for its growing role. The 2003 assessment did not consider this to be problematic given the small size of the investment services market in Monaco and the limited role of the two Commissions. The CCAF has 9 part time Commissioners. The full-time staff consists of 6 persons including the Secretary General. The Secretary General has extensive experience of fund management in the private sector. There are two inspectors of portfolio management companies. Staff from the Autorité des Marchés Financiers (AMF) in Paris visit Monaco regularly to inspect on behalf of the CCAF the seven companies which manage CISs and their depositories for compliance with Monegasque regulations. These numbers are unchanged since 2003. However the number of portfolio management firms active in Monaco has risen from 24 in 2003 to 41 at the end of 2007.[5] The CCAF is solely responsible for supervising these companies and has taken over the licensing role under the 2007 legislation. It has also been given the power to issue administrative sanctions. It is increasingly engaged in setting standards of client facing conduct based on the high level principles set out in the new legislation. The government's goal is to attract more of such companies to Monaco including hedge fund managers, private equity firms and the managers of foreign funds. Many of these new entrants exhibit important differences to the established CIS managers. They are small and not part of larger groups and therefore do not rely on in-house products which are managed outside Monaco. Some manage funds of greater complexity and arguably of higher risk to investors than traditional long only collective investment schemes with minimal leverage. It is recommended that staffing levels in the Commission be reviewed given its growing role and the recommendations in this assessment for enhancing that role.

15. The Commission's budget: The budget is part of the State's expenses. The 2003 assessment made no comment on this, given that at that time the two Commissions were not independent in any sense. This has now changed and it may be appropriate to ask whether this is the optimal way to fund the CCAF. Generally the options are funding in its entirety by the government, funding in its entirety by the local financial services industry and issuers or a mix of both. IOSCO does not have a definitive view and prefers to concentrate on whether the regulator receives sufficient funding and is able to control the operational allocation of resources once funded. However, funding solely by government can expose a regulator to

[5]Portfolio management firms manage individual portfolios and specialized funds other than Collective Investment Schemes (CISs).

possible political pressure, while funding solely by the industry, particularly in a small and concentrated market such as Monaco, risks regulatory capture. This analysis suggests that there is a balance to be struck. The Secretary General noted that this topic is one of a number of issues to be progressed in 2008 in the context of the resources necessary for regulation as all parties develop experience with the operation of the new Commission which was established only in September 2007. This assessment update agrees that the topic of the structure of the Commission's funding should be on the current agenda of discussions with the Government.

Self Regulation: Principles 6 and 7

16. Self regulation has begun to play a part in Monaco. These Principles were originally assessed as not applicable as there were no self regulatory organizations in Monaco. However, under Article 21 of Act 1.338 all authorized companies must now join the AMAF. The AMAF makes recommendations on a range of issues governing its members' conduct and expanding on the legislative and regulatory requirements which are often set at a principles-based level. Although not binding, these recommendations are used by the CCAF when conducting inspections as a means of assessing compliance. A firm is required to demonstrate compelling reasons for not following the recommendations. The AMAF reports problems with members to the CCAF which, if not resolved, may be used by the CCAF in reassessing a firm's fitness and properness. These processes are indicative of a growing level of self regulation which was an intended consequence of the 2007 legislation. The model is very similar to that adopted in France where banks and brokers must join the relevant association and where failure to comply with its recommendations are viewed as potentially disciplinary offences by the statutory regulator the AMF. The French brokers' association (Association Française des Entreprises d'Investissement) is a member of the IOSCO Self Regulatory Organizations Consultative Committee. AMAF recommendations are always issued after prior review by the CCAF and the President of the AMAF is a member of the Commission.

Enforcement: Principles 8–10

17. Although these Principles were assessed as implemented the report made several recommendations. Several have been accepted.

18. It was noted in 2003 that the authorities do not carry out market surveillance activities. While there may be some justification in that position given that there has been no "market" in Monaco, licensed firms were, and still are, entering orders on other markets via brokers and dealers in other jurisdictions (whether as mere transmitters or fund managers). This assessment update therefore recommends that the CCAF equips itself to become better informed on what Monegasque originated business is being executed in overseas markets.

19. Under Article 10 of Act 1.338 the CCAF now has a power to impose administrative sanctions as set out in Section IV of Act 1.138 (A34–42). It lacks a fining power which is generally viewed as a significant weakness although it is not required under IOSCO Principle 8 if suitable alternative powers exist. That is not the case of the CCAF. It has no sanctions available between issuing a warning or a reprimand and a temporary suspension or permanent revocation of a license. It cannot administer sanctions against individuals although it can seek the removal of an individual by reference to the fitness and properness of the licensed firm. Conversely the potential penalties under the criminal law which can be applied by the courts against individuals can be severe.[6]

20. Article 13 of Act 1.338 has clarified that the CCAF is fully empowered to conduct investigations into mutual funds and other collective investment schemes authorized under Monegasque law. Previously there was some ambiguity concerning the powers of the previous Commission to enter the premises of a mutual fund manager.

Cooperation: Principles 11–13

21. Principles 11 and 12 were assessed as partly implemented which indicated major weaknesses in this key area. Given the growing globalization of markets and the ease and speed with which transactions can be carried out cross border, regulators recognize the need to cooperate fully in deterring and punishing behavior which damages the integrity of capital markets. The assessment made several recommendations:

- Amend the portfolio management law to clearly permit sharing of information regarding the portfolio management activities of banks.
- Amend the law to allow the mutual fund supervisory commission to enter information sharing agreements and establish Memoranda of Understanding (MoUs) for information sharing with the Commission des Opérations de Bourse (COB—the predecessor body to the AMF) and other regulators.
- Establish MoUs for information sharing with other regulators.
- Establish a formal information sharing system with the Commission Bancaire.

22. Since 2003 there have been some improvements. Prudential information can be provided at the request of overseas regulators when the Monegasque licensed company is part of a group headquartered outside Monaco (Para 1 Article 16 Act 1.338).

[6] For example, a conviction for failing to act in the sole interest of a client carries a potential prison sentence of one to five years (Article 45(3) Act 1.338).

23. Two major problems remain. First, under Monegasque law information exchange concerning possible market related offences, such as insider dealing and other forms of market abuse, can be provided to foreign regulators responsible for market supervision only if an MoU has been signed between the CCAF and the overseas authorities. In 2003 only one MoU existed, between one of the original Monegasque Commissions and the COB (the then French regulator). The new Commissions in Monaco and France, CCAF and AMF, continue to exchange information based on this agreement.[7] Three additional MoUs have been signed since 2003— with the Commissione Nazionale per le Società e la Borsa (CONSOB—Italy), the Commission de Surveillance du Secteur Financier (CSSF—Luxemburg), and the Commission Bancaire, Financière, et des Assurances (CBFA—Belgium). Discussions have begun with the UK Financial Services Authority and the Swiss authorities.

24. In 2007 Monaco received 11 requests for assistance on market abuse, primarily concerning insider trading. The AMF made 10 requests and CONSOB one, both of which have an MoU with the CCAF.

25. As a practical matter the CCAF states that, given the current legal constraints, its policy as regards negotiating MoUs is based on seeking to do so in order of priority as regards the frequency of requests for information. France and Italy were and remain the most frequent requestors of information.

26. Current international good practice does not require an MoU to be in place as a necessary precondition for information to be exchanged or assistance provided. Rather an MoU serves two purposes. First, it is an indication of good faith by a regulator in demonstrating a willingness to exchange otherwise confidential information with its peers concerning conduct which may damage the integrity of capital markets. Second, it facilitates the exchange of information by setting out in advance the terms agreed between the parties as to the purposes for which the information is sought, the uses to which it will be put, the responsibilities of requestor and requestee authority and the circumstances in which the requested party will have the right to decline to provide the information. By so doing it minimizes the need to enter into extensive discussions on these topics each time a request for

[7] According to the AMF the level of cooperation is good. Most cases for which assistance has been sought involve insider trading. All concerned individuals dealing through a Monaco bank, and not Monaco based fund managers. Generally the individuals appear to have operated alone although there is a current case which might involve a more organized approach. The Monegasque authorities have identified the individuals concerned, have interviewed them and in some cases have arranged for the AMF staff to interview them in Monaco (on a voluntary basis on the part of the suspect). The CSSF and the CBFA have stated that they are satisfied with the arrangements. CONSOB has had satisfactory responses and notes that although under the terms of the MoU the Monegasque government has the right to refuse to disclose identities of account holders etc. it does not in practice do so.

information or assistance is made. Most regulators claim that they will attempt to provide assistance whether or not an MoU is in place.

27. Even within Monaco the approach to cooperation with foreign regulators set out in Article16 of Act 1.338 is not followed elsewhere. According to the Service d'Information et de Contrôle sur les Circuits Financiers (SICCFIN—the Monegasque Financial Intelligence Unit) its membership of the Egmont group of over 100 Financial Intelligence Units has removed the need for MoUs and although SICCFIN has 25 in place it is able to exchange information with other Egmont group members with few constraints.

28. The second problem in the new legislation is the extremely demanding obligation on the party receiving the information to commit to keeping it secret or, in the words of Article 17 Act 1.338 "Information may be provided ….only…on condition that the authority concerned is bound by a professional secrecy obligation offering the same guarantees as in the Principality." While that guarantee may not be absolute in Monaco it sets a standard (i.e. the standard of the requested authority) that is not consistent with good international practice. Two examples will demonstrate.

29. The IOSCO Multilateral MoU (MMoU) at Article 10 imposes only a "best efforts" obligation on the requesting authority and, in the event the requesting authority receives a legally enforceable demand, an obligation to "assert such appropriate legal exemptions or privileges with respect to such information as may be available."

30. Within the European Union (EU) the Market Abuse Directive (MAD) (2003/6/EC) at Article 16 requires cooperation between Member States and the exchange of information in investigation activities. Information provided is covered by the professional secrecy requirements imposed on the persons employed by the requesting authority not the requested authority.

31. The MMoU of the Committee of European Securities Regulators (CESR) on the Exchange of Information and Surveillance of Securities Activities (CESR; 05_335) states clearly that it is an "understanding" and the "most expedient way to achieve a necessary consensus." It is not a legally binding document. Article 1 states that it should be read "without prejudice to the provisions set forth by the EU legislation." And so, although it contains one Article with a degree of ambiguity, it has to be read in that context.[8]

[8] Article 6.4 requires the prior consent of the requested Authority before using or disclosing information provided for any purpose other than (i) pursuant to a relevant EU Directive or, (ii) broadly, to pursue breaches of laws and regulations concerning insider dealing, market manipulation and other fraudulent practices in the securities field. If the requested Authority consents, it may impose conditions.

Furthermore, Article 5 permits the requesting Authority to disclose information where such disclosure is required in order to comply with its obligations under a European directive.

32. Having examined the new legislation and discussed the issues with the CCAF this assessment update makes two recommendations for action concerning information exchange with foreign regulatory authorities responsible for market supervision:

33. It is recommended that Article16 of Act 1.338 be amended to reflect good international practice by permitting the CCAF to exchange information and perform or commission investigations on market related matters without necessarily having first negotiated an MoU with the requesting foreign authority.

34. It is recommended that Article 17 of Act 1.338 be amended to reflect a more pragmatic approach to confidentiality consistent with good international practice as set out in the IOSCO and CESR MMoUs which would permit greater and easier cross border flow of information concerning insider dealing and market manipulation.

35. Domestically, arrangements to share information are still not completely satisfactory although the merging of the two commissions has removed one problem. However the CCAF still lacks the ability formally to exchange information with the SICCFIN. Work is underway to resolve this and in the meantime a mechanism has been found using the Coordinating Committee which was set up in 2002 to discuss a broad range of financial services issues. The SICCFIN has a seat on the Committee as do the DEE and the Department of Budget and Tresor. This provides a forum for the exchange of information when necessary. It can meet at short notice if required. The CCAF is not a permanent member but it is invited when appropriate as an expert. It might be preferable for the CCAF to be a permanent member of the Committee. It was suggested by the authorities that this might compromise the independence of the CCAF. That would depend on the terms on which membership was granted. As long as the CCAF was entitled to keep confidential information in its possession but was able to volunteer information if it thought that this would, for example, assist in preventing wrong-doing, its independence would not be compromised. Clearly the reverse would be true if by virtue of its membership it were obliged to provide confidential information on cases to a government department.

36. Of the four specific recommendations in 2003 the first two have been resolved by the merger of the two commissions and the third has been implemented. The fourth has not been implemented and the CCAF does not see further formal information sharing arrangements with the Commission Bancaire (CB) accruing any additional benefits beyond what they can already achieve through existing communications channels. One of those channels however utilizes the Commissaire du Gouvernement who represents Monaco on the CB when Monegasque matters are discussed. If the recommendation is accepted that his presence on

the Commission is not compatible with a fully independent Commission, alternative arrangements will have to be made.

Issuers: Principles 14–16

37. These were assessed as not applicable except for Principle 16 on accounting standards which was assessed as implemented. Currently, there are only two Monegasque companies whose securities trade publicly. They trade on the lower sections of Euronext Paris, the Second Marché and the Marché Libre. This minimal number of issuers does not merit detailed re-assessment of Principles 14 and 15. Such takeover activity as occurs in the Principality involves the negotiated sale of wholly owned corporate subsidiaries to other companies.

Collective Investment Schemes: Principles 17–20

38. In the EU, improving the regulation of CISs is a continuous process which shows no signs of coming to an end. Since Monaco bases its regulation on the EU Directives on Undertakings for Collective Investment in Transferable Securities (UCITS) and the various implementing Directives, Regulations and Recommendations which flow from them, this process is replicated in the Principality. For example, a recent Ministerial Order (MO) on the simplified prospectus may need amending when the EU Commission decides what to do with recently published CESR advice on the same topic. A further MO (MO 2008–50) on the licensing requirements for Monegasque funds will be finalized shortly.

39. In the 2003 assessment Principle 17 was assessed as partly implemented because of the lack of conflicts of interest rules governing trading restrictions and personal dealing reporting requirements on staff and managements of mutual funds. The assessment also recommended the creation of rules governing related party transactions by mutual funds. The authority's response was to note that Article 7.4 of SO 1.284 of September 10, 2007 requires a firm to "endeavor to avoid conflicts of interest and if such conflicts cannot be avoided, ensure that their customers are treated fairly." This sets the obligation at a relatively high level of generality and would be regarded by many regulators as in need of some elaboration.[9] Following a meeting with the mission the AMAF in its self regulatory role has offered to develop recommendations to its members in this area. As noted above, failure to comply with AMAF recommendations may be taken into account by the CCAF when considering whether a breach of regulations has occurred.

[9] The Markets in Financial Instruments Directive (2004/39/EC) treats the identification, management and disclosure of conflicts of interest as one of the most important aspects of investor protection and deals with it in great detail.

40. The licensing requirement of the CCAF for managers of foreign funds under the new legislation will reflect the additional risks identified by the authorities in the "boutique" nature of some of the prospective managers (i.e., small teams without deep pocketed parents) and the greater variety and more complex nature of the funds under management. Thus initial capital requirements will be higher (€450,000 vs. €300,000) and the professional skills demanded of the individuals concerned and the systems and controls of the companies will be higher. The nature of the current and proposed client bases will be scrutinized more closely

41. Although Principle 20 was assessed as implemented the assessment made several recommendations;

- For the provision of more detailed requirements for the valuation of illiquid securities. According to the authorities this is being addressed across the fund management industry: CISs and other investment funds (such as hedge funds, property funds and venture capital funds) where there will shortly be published requirements for stress testing and scenario testing.
- For clearer disclosure to investors as to the accounting standards used in the preparation of a fund's financial statements. According to the authorities this is being discussed with the OEC, which has showed a receptive attitude to this change.[10]
- For a power for the Minister of State to prohibit a fund from suspending redemptions where such an action would harm investors. Article 10 of Act 1.339 does not provide for this specific power but does require the CCAF to be informed in advance of a suspension which must be consistent with the fund's by-laws which will have been approved by the CCAF. Further conditions are to be established shortly by Ministerial Order.
- For daily net asset valuation to be required for all funds (including small ones). New rules governing valuations are set out in Article 4(11) of SO 1.285 of September, 2007, which requires valuation and publication at least twice a month (or once a month if that would not be detrimental to investors). The authorities note that the current provisions of Article 4(11) SO 1.285 replicate those required in the EU under the UCITS III Directive (Article 34 consolidated text).

42. Since the 2003 assessment, globally the mutual funds industry has suffered from several examples of abuse, particularly in the United States, over market timing and late trading which has given preferential treatment to certain clients. The CCAF is conscious of

[10] The recent purchase of a 25 percent stake in a local firm by one of the three big accounting firms is likely to increase the exposure of local firms to the latest international standards.

these problems and considers that it might be appropriate to make specific provision for them when Act 1.338 is updated. However there is no evidence to date that these abuses have occurred in Monaco.

Market Intermediaries: Principles 21–24

43. Principle 24 was assessed as partly implemented because of the absence of a plan to deal with the transfer of client accounts, notification to clients etc. in the event of the failure of a portfolio manager. The CCAF's response was two-fold. It acknowledged that no plan exists for the failure of a nonbank portfolio manager but notes that these firms are not permitted to hold client funds or securities. While the risks in the event of a failure are therefore limited, there may be cases in which investors interests are put at risk and it would therefore be useful if the CCAF was to develop a plan. As regards banks which are also licensed as portfolio managers, the authorities noted in 2003 that they are prudentially supervised by the CB in Paris which has contingency plans in place. Also, the banking regulations (Rule 97.02) require banks to have contingency plans in place. In subsequent discussions the CCAF agreed to look again at developing its own contingency plan.

44. On other issues, under Principle 22 the assessment recommended that the definition of reception and transmission of orders be clarified to differentiate this low risk activity from higher risk brokerage activity. This has not been done although a recent survey conducted by the CCAF revealed that in practice firms are complying with the terms of the legislation.

45. The assessment also recommended more frequent reporting by fund management companies to the regulators, for example on a quarterly basis, and shortening the six months period for filing audited annual accounts. As for collective investment schemes the deadlines are those set out in UCITS III (six monthly with up to eight weeks delay) and for investment funds the period is quarterly. For fund management companies the six month deadline for annual accounts remains but discussions with the industry concerning a reduction to around four months are underway.

46. On detailed conduct of business and internal control requirements more generally (Principle 23) SO 1.284 imposes specific conduct of business obligations but, as with its provisions on conflicts of interest, at a high level of generality. While this is consistent with principles based regulation which is becoming more accepted by many regulators, it is generally accepted that further guidance is needed as to what appropriate conduct should be than is present in the Monegasque law. As noted above in the section on Principles applicable to the regulator, the CCAF is developing informal processes to secure high standards in areas such as investment mandates. The AMAF may be an alternative mechanism for developing such guidance on a self regulatory basis although the CCAF is clear that it will wish to remain in a dominant position were the AMAF to take on such a role. The assessment agrees with that view.

47. The 2003 assessment noted that insider dealing had recently been made a criminal offence (in 2001) but that at that time no specific requirements for insider trading monitoring or reporting had been introduced. It was recommended that the DEE should work with portfolio managers to establish policies and procedures for insider trading monitoring and compliance with the insider dealing law, to be followed up in the on-going inspection program. The responsibility now falls to the CCAF not the DEE. However, no action has been taken. The recommendation concerning monitoring is also reflected in the MAD Implementing Directive (2004/72/EC) which requires authorized firms to report suspicious transactions to their regulator, replicating the anti money laundering obligations which Monaco has adopted. It is recommended that reporting to the CCAF of transactions which create a reasonable suspicion of insider dealing or market manipulation should be made obligatory for licensed firms and the CCAF should develop the expertise to analyze such reports so as to take timely corrective actions.

Secondary Markets: Principles 25–30

48. These principles were assessed as not applicable as there is no market for securities or derivatives in Monaco and in 2003 investment activities did not include the execution of orders for third parties (broking) or trading for own account (dealing with or for third parties). However, Principle 28 requires a jurisdiction to have regulations designed to detect and deter manipulation and other unfair trading practices. Increasingly insider dealing and market manipulation activities have a cross border element particularly as a means of hiding the identity of the perpetrators. Europe recognized this dimension when passing the MAD where the offence can be committed in any Member state when the trade or trades is/are executed on a regulated market in another Member State. The IOSCO MMoU operates on the same basis. Furthermore, the insider dealing offence is narrowly defined (Article 49 Act 1.338, 2007) and there is no offence of market manipulation other than the narrow one of spreading false information about an issuer where such information is liable to have an effect on the price of its securities (Article 49 Act 1.338). Compared to definitions of insider dealing and market manipulation in the MAD these provisions seem seriously inadequate, although should a conviction be obtained for insider dealing the potential sanctions are significant—two years in prison and a fine of 10 times the profit made. It is recommended that the legislation is amended to bring the offences of insider dealing and market manipulation into line with international best practice.

III. Recommendations for Action and Authorities' Reactions

A. Recommendations

High priority

- Article 16 of Act 1.338 should be amended to reflect good international practice by permitting the CCAF to exchange information and perform or commission investigations on market related matters without necessarily having first negotiated an MoU with the requesting foreign authority.

- Article 17 of Act 1.338 should be amended to reflect a more pragmatic approach to confidentiality consistent with good international practice, and which would permit the greater and easier cross border flow of information concerning insider dealing and market manipulation.

- Reporting to the CCAF of transactions which create reasonable suspicion of insider dealing or market manipulation should be made obligatory for licensed firms and CCAF should develop the expertise to analyze and action such reports.

- Act 1.338 should be amended to bring the offences of insider dealing and market manipulation into line with international best practice.

- The present institutional arrangements should be reviewed whereby Monaco contracts with the French mutual fund regulator, AMF for its staff to inspect Monaco based collective investment scheme fund managers and depositories for compliance with Monegasque law and regulation.

- Conflicts of interest policies should be adopted for commission members and staff (including reporting of trades) along with monitoring of compliance.

Medium priority

- Commission members should be protected from liability while carrying out duties in good faith.

- The criteria by which the Government might legitimately remove a member of the Commission should be set out in law.

- Staffing levels in the Commission should be reviewed given its growing role and the recommendations in this assessment for enhancing that role.

- When the CCAF has had an opportunity to gain experience and reputation as the single Monegasque regulator, the presence of the Commissaire du Gouvernement should no longer be mandated at Commission meetings particularly when decisions on operational matters such as licensing and administrative sanctions are to be taken.

- The CCAF should equip itself to become better informed on what Monegasque originated business is being executed in overseas markets.

- The CCAF should develop a contingency plan for dealing with the failure of a licensed company.

Low priority

- The structure of the Commission's funding should be on the current agenda of the Government.

B. Authorities' Reactions

49. The Monegasque authorities consider the recommendations as very valuable. The CCAF understands the concerns expressed by the mission regarding the participation of the Commissaire du Gouvernement at the meetings of the Commission. Nevertheless, the CCAF wishes to emphasize that the Commissaire du Gouvernement is not a full member of the Commission and has no voting rights, nor can he ask for a second deliberation of the Commission. His presence aims at keeping the CCAF members regularly informed on the general matters dealt with by the Government (e.g., the IMF assessment) and vice-versa. As also reported by the mission, the Commissaire du Gouvernement participates at the meetings of the CB board when it deliberates on Monegasque matters. Thus the Commissaire du Gouvernement plays a crucial role of liaison among different regulatory and supervisory bodies.

50. Moreover, the CCAF and the AMF wish to confirm that they are both willing to maintain their cooperation in the supervision of the Monegasque financial sector, which has always proved efficient. In this regard, the 1992 agreement governing cooperation for on-site inspections will be promptly updated to take into account the evolution of the legal and economic environment. The CCAF would also like to observe that there cannot be any duplication of controls since the AMF staff only acts on behalf of the CCAF. All inspections decisions are taken by the CCAF. The CCAF defines each year a comprehensive inspection program in order to avoid any duplication.

Finally, The CCAF is of the view that the requirements of a formal MoU and equivalent professional secrecy obligation are not material impediments to the exchange of information with foreign supervisory authorities. Although on some occasions the information given

could not be as complete as requested by the foreign authority in the absence of a MoU, the Direction du Budget et du Trésor, in charge of the matter until September 2007, has always made its best efforts to provide assistance to the requiring authorities by providing any information - not covered by professional secrecy - that could prove useful. Moreover, Monaco has not turned down any proposal of a country to enter into negotiation with a view to signing of a bilateral MoU. Indeed the Principality is firmly convinced that cooperation procedures set out in an MoU facilitate the smooth flow of information when an exchange of information needs to take place rapidly.