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Staff Country Reports

**Cook Islands: Assessment of the Supervision and Regulation of the Financial Sector
Volume I—Review of Financial Sector Regulation and Supervision**

This review of financial sector regulation and supervision in the **Cook Islands** in the context of the offshore financial center assessment program contains technical advice and recommendations given by the staff team of the International Monetary Fund in response to the authorities of the **Cook Islands'** request for technical assistance. It is based on the information available at the time it was completed in **October 2004**. The staff's detailed assessment of the observance of standards and codes can be found in Volume II. The views expressed in these documents are those of the staff team and do not necessarily reflect the views of the government of the **Cook Islands** or the Executive Board of the IMF.

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**ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE
FINANCIAL SECTOR**



**Volume I: Review of Financial Sector Regulation
and Supervision**

Cook Islands

OCTOBER 2004

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GLOSSARY

AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
APG	Asia Pacific Group on Money Laundering
BA	Banking Act 2003
BCI	Bank of the Cook Islands
CA	Crimes Act 1969
CFT	Combating the Financing of Terrorism
CID	FTRR (Customer Identification)
CIG	Cook Islands Government
CIP	Cook Islands Police
CLAG	Combined Law Agency Group
CLO	Crown Law Office
CPA	Criminal Procedure Act 1980-81
CPAA	Criminal Procedure Amendment Act 2003
EA	Extradition Act 2003
ER	Extradition Regulations 2004
FATF	Financial Action Task Force on Money Laundering
FIU	Financial Intelligence Unit
FSC	Financial Services Commission
FSCA	Financial Services Commission Act 2003
FT	Financing of Terrorism
FTRA	Financial Transactions Reporting Act 2003
FTRR	Financial Transactions Reporting Regulations 2004
IAE	Independent AML/CFT Expert
ICA	International Companies Act 1981–82
ICR	International Companies (Evidence of Identity) Regulations 2004
ICSFT	International Convention for the Suppression of the Financing of Terrorism
LEG	Legal Department, IMF
MACMA	Mutual Assistance in Criminal Matters Act 2003
MACMAA	Mutual Assistance in Criminal Matters Amendment Act 2003
MFD	Monetary and Financial Systems Department, IMF
ML	Money Laundering
NCCT	Noncooperative Countries or Territories
PCR	Proceeds of Crime (Border Currency Report Form) Regulations 2004
PFTAC	Pacific Financial Technical Training Centre
POCA	Proceeds of Crime Act 2003
ROSC	Report on the Observance of Standards and Codes
TCA	Trustee Companies Act 1981–82
UNSCR	United Nations Security Council Resolution
UNSCRA	United Nations (Security Council Resolutions) Act 2003

PREFACE

The Offshore Financial Center Assessment Report for the Cook Islands assesses supervision in the banking sector on the basis of the Basel Committee's Core Principles for Effective Banking Supervision and the regime for the anti-money laundering and combating the financing of terrorism (AML/CFT) based on the October 2002 AML/CFT Methodology.

The assessments were carried out during a mission from February 16–27, 2004 whose members included Mr. Ian Carrington (Mission Chief), Mr. Peter Csonka (Senior Counsel, LEG), Ms. Desiree Cherebin and Mr. Joel Shapiro (Consultants, Banking Supervision), Mr. Steven Gilbert (Consultant, AML/CFT) and Claudia Mariel (Mission Assistant). An independent AML/CFT expert, not under the supervision of the IMF, Detective Senior Inspector Simon Leung Chin-keung of the Hong Kong Police Force, evaluated the law enforcement sections of the methodology. Ms. Judy Lau of the Pacific Financial Technical Assistance Centre (PFTAC) joined the mission as an observer.

The members of the mission met with the Prime Minister, The Honorable Dr. Robert Woonton, the NCCT Working Group, the Financial Services Commission, the Financial Intelligence Unit, the Solicitor General's Office, the Ministry of Justice, the Ministry of Foreign Affairs, the Police, and the Customs Department. The mission also met with the New Zealand High Commissioner, representatives of various financial institutions, auditors, trustees, and the Law Society.

The members of the mission wish to express their gratitude to the Cook Islands authorities and the staff of all the institutions that they visited and with whom they worked during their stay for their cooperation, and openness in sharing insights and information. The feedback provided by the authorities during all meetings was particularly useful in strengthening the report.

EXECUTIVE SUMMARY

Offshore financial activity commenced in the Cook Islands (CI) in 1981 with the enactment of several laws, which provided, as a basic inducement, for all registered offshore entities to be exempt from all forms of tax. The legislation also imposed strict confidentiality provisions relating to the incorporation, ownership, and activities of such entities.

There are three domestic banking operations in the CI, including branches of the ANZ and Westpac from Australia and the local Bank of the Cook Islands. Until recently, the Cook Islands offered three categories of license for offshore banking activity.

Trustee companies play a pivotal role in the CI offshore sector. They provide trust and company formation and administration services. The law requires that the incorporation of international companies must be undertaken by trustee companies and any offshore institutions that do not have a physical presence in the islands must operate through one of these entities. They also act as introducers of business to many of the institutions operating in the offshore sector.

In response to its listing under the FATF's NCCT initiative, the Cook Islands has taken a number of measures to strengthen its financial sector regulation. New legislation was passed for the regulation of banking activity and a Financial Supervisory Commission (FSC) was established. A suite of anti-money laundering legislation was enacted in May 2003 with work ongoing in respect of legislation for combating the financing of terrorism.

The new Banking Act and FSC Act provide a good basis for sound financial sector regulation. They provide the basic framework for authorization and effective supervision of licensed entities. The major challenges facing the FSC include the training and retention of appropriately qualified personnel and the development of an adequate range of regulations, guidance notes, and general supervisory tools.

Key Recommendations

ISSUE	COMMENT
BCP	
Resources	The Commission should explore creative ways under which senior staff can be attracted from the Cook Islands Diaspora, especially in New Zealand, as well as locally.
Independence	The Commissioner should not be in a position where routine operational issues are presented to the Board prior to or concurrently with action taken. The Board should be involved intimately with policy matters, but not in the day-to-day operations of the Commission.
Licensing	A comprehensive list of licensed financial institutions should be published in a manner that is readily accessible to the public, indicating that any other

	<p>institutions purporting to be licensed with the Commission are operating in contravention of existing law.</p> <p>In the event the Commission becomes aware that an institution is conducting a banking business without a license, it should post warning notices, and where practicable, take legal action against the institution.</p>
On-site and Off-site supervision	<p>The FSC should establish a comprehensive training program for all supervision staff. In addition, the Commission must issue prudential returns in a number of critical areas of banking activity and risk management to ensure that all licensed financial institutions adopt international best practice and are advised as to the nature of policy and practice that the Commission expects. Supervisory tools, such as an examination manual and examination report template, also must be developed, together with evaluation tools for such areas as credit, market, and liquidity risk.</p>
AML/CFT	
International Treaties	<p>The Convention for the Suppression of the Financing of Terrorism should be ratified.</p> <p>The Vienna and Palermo Conventions should be signed.</p>
Financing of Terrorism	<p>FT should be criminalized as a matter of priority.</p>
Monitoring Compliance	<p>The FSC should train its staff and develop appropriate methodologies to undertake its monitoring responsibilities under the FTRA.</p> <p>The FIU should be adequately resourced to undertake its compliance function under the FTRA.</p>
Guidance Notes	<p>Revised guidance notes that are consistent with the new AML legislation should be issued to industry.</p>
Trustee Companies / International Companies	<p>The FSC needs to develop an effective mechanism to undertake meaningful supervisory surveillance of trustee companies and the Registrar of Companies should ensure that the beneficial owners of ICs are identified, verified, and this information is kept updated.</p>

I. INTRODUCTION

1. At the invitation of the Government of the Cook Islands, a Module 2 offshore financial center (OFC) assessment of financial regulation and supervision in the Cook Islands was carried out from February 16–27, 2004, within the framework of the OFC Assessment Program approved by the Executive Board of the Fund in July 2000. Assessments were undertaken of the regulation and supervision of the banking sector, and of the arrangements in place for AML/CFT.

2. Volume I of the report briefly describes the financial system and regulatory and supervisory arrangements for the financial sector in the Cook Islands and provides Reports on Standards and Codes (ROSCs) based on the detailed assessments in Volume II. Volume II provides the detailed assessments carried out on the basis of the Basel Core Principles for Effective Banking Supervision, and the AML/CFT methodology for assessing compliance with the Financial Action Task Force's 40+8 Recommendations.

II. FINANCIAL SYSTEM OVERVIEW

3. This section provides an overview of the financial institutions and markets in the Cook Islands and the legal and institutional framework for the regulation and supervision of the financial system.

A. Background

4. The CI consists of a group of 15 islands with a total land area of approximately 90 square miles. They are located 1,600 miles north-east of New Zealand and 2,800 miles south of Hawaii.

Government

5. The CI is a self-governing parliamentary democracy. The Government is comprised of a prime minister, a cabinet, a 24-member legislature of elected members, and a chamber of hereditary chiefs who sit in the 15-member House of Ariki. CI was a colony of New Zealand until 1965. Since then, it has had the status of a self-governing state in free association with New Zealand. Under this arrangement, the government of the CI is responsible for its internal affairs while New Zealand bears responsibility for defense and external affairs.

Economic activity

6. In 2002, the services, agriculture, and industrial sectors accounted for 83.3 percent, 13.1 percent and 3.6 percent of GDP, respectively. During the period 1995–1998, the islands experienced an economic recession. Over the four-year period, GDP contracted by

3.2 percent, 0.3 percent, 2.3 percent, and 0.8 percent, respectively.¹ Following the downturn, an Economic Recovery Program was implemented to bring about macroeconomic stability, reduce government's role in the economy, increase private sector participation, and mitigate the social cost associated with adjustment. The program was instrumental in resolving the government's fiscal crisis and creating growth in private sector activity, but was less successful in mitigating the social cost of reforms.² Since 1998, GDP has increased on average by 6 percent per annum. GDP per capita for 2002 was estimated to be NZ\$10,537.³ Provisional estimates for September 2003 place the population normally resident in the Cook Islands at 13,800.⁴

B. Financial Institutions and Markets

Offshore sector—Overview

7. The OFC was established in 1981 through the enactment of several laws, which provided as a basic inducement, for all registered offshore entities to be exempt from all forms of tax. The legislation also imposed strict confidentiality provisions relating to the incorporation, ownership, and activities of such entities. At the heart of the sector are some 800 international companies and approximately 2,100 international trusts. The peak period for activity in the OFC was 1986–1991 when there was strong demand for corporate vehicles from Australasian clients, but this demand has all but disappeared, and in recent years there has been a general decline in business.

8. Registration and license fees represent about 4 percent of government revenues, and industry estimates put the total contribution of the offshore sector at something over 8 percent of GDP. About 80 persons are directly employed in the offshore sector.⁵

9. The CI has become best known for specializing in the establishment of asset protection trusts, with much of the client base (mostly wealthy professionals) originating from the United States. Typically in such arrangements, the local trustee companies act as passive co-trustees, only assuming an active role when the protection clauses within the trust deed are triggered by some perceived threat to the assets.⁶

¹ Cook Islands Annual Statistical Bulletin (2003).

² Source: <http://www.adb.org>.

³ Cook Islands Annual Statistical Bulletin (2003).

⁴ Cook Islands Annual Statistical Bulletin (2003).

⁵ MFD TA Report Cook Islands (2003).

⁶ MFD TA Report Cook Islands (2003).

Banks

10. There are three domestic banking operations in the CI, including branches of the ANZ and Westpac from Australia and the BCI. The BCI was formed in 2001 by the merger of two government-owned financial institutions, the Cook Islands Development Bank and the Post Office Savings Bank.

11. Offshore banking activity in CI dates back to 1981 with the advent of the Offshore Banking Act. The Banking Act 2003 provides for the following categories of licenses:

Category	Characteristics of License
Domestic	Authorizes licensees to carry on domestic banking business in and from within the Cook Islands.
International	Authorizes licensees to carry on international banking business in or from within the Cook Islands.
Restricted International	Authorizes licensees to carry on international banking business of a type and nature specified in the license and approved by the FSC.

Trustee companies

12. Trustee companies play a pivotal role in the CI offshore sector. They provide trust and company formation and administration services. The law requires that the incorporation of international companies must be undertaken by trustee companies and any offshore institutions that do not have a physical presence in the islands must operate through one of these entities. They act as introducers of business to many of the institutions operating in the offshore sector.

Insurance companies

13. Insurance products that are marketed locally are offered by local agents on behalf of foreign insurance companies. There are currently 20 institutions operating in the offshore sector and the government sees this as the only area of potential growth within the sector. Information is not readily available about the operation of these entities, but they are believed to operate essentially as captives.⁷

⁷ A captive insurance company is a separate legal entity, which provides insurance for a non-insurer parent company's and other corporate group members' risks.

Financial Supervisory Commission

14. Under the Financial Supervisory Commission (FSC) Act, which was passed in May 2003, the FSC has responsibility for the regulation and supervision of licensed financial institutions and administers the following legislation:

- The Banking Act 2003;
- The Trustee Companies Act 1981–82;
- The Offshore Insurance Act 1981–82,
- The Insurance Companies' Deposits Act 1970–71;
- The International Companies Act 1981–82;
- The International Companies Amendment Act 2003;
- The International Trusts Act 1984; and
- The International Partnerships Act 1984.

15. The FSC is headed by a Board of Directors comprised of a Chairman and four members. At the professional level, its executive staff is comprised of a Commissioner, a Deputy Commissioner, a senior supervisor, two supervisors, a registrar, and a deputy registrar. The previous Deputy Commissioner resigned with effect from February 16, 2004, while the senior supervisor's position was filled in March 2004.

16. The FSC has taken over the role formerly carried out by the Office of the Commissioner of Offshore Financial Services. This office was under-resourced and in recent years devoted much of its time to responding to a number of international initiatives. It was, therefore, unable to effectively carry out its regulatory functions. Much of its activity was associated with processing license applications.

17. The FSC has prepared a two-year work program (October 2003–September 2005). During the earlier part of the program, the FSC plans to prepare industry profiles, develop an effective licensing and supervisory regime, and draft regulations to support its supervisory activity. The latter part of the program will see the establishment of off-site monitoring procedures for banks, the development of off-site and on-site monitoring of nonbank financial institutions, and the development of manuals of such systems and procedures.

Anti-money laundering and combating the financing of terrorism

18. Due to international pressure, the CI enacted AML legislation in 2000, the Money Laundering Prevention Act 2000, followed by the issuance of *Guidance on the Prevention of Money Laundering*. In early 2002, the *Money Laundering Prevention Regulations* were passed. The Guidance Notes were updated with a *Draft Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cook Islands*.

19. Following work undertaken by an IMF TA mission in 2002 and other donors and international organizations, the above-mentioned legislation was repealed and replaced by the following suite of laws:

- Proceeds of Crime Act 2003;
- Proceeds of Crime 2003 Amendment Act;
- Crimes Act 1969 Amendment Act;
- Criminal Procedure Act 1980–81 Amendment Act;
- Financial Transaction Reporting Act 2003;
- Extradition Act 2003;
- Mutual Assistance in Criminal Matters Act 2003;
- Mutual Assistance in Criminal Matters Amendment Act;
- Banking Act 2003; and
- Bank of Cook Islands Act 2003.

20. The authorities are also in the process of drafting CFT legislation based on the model law drafted by the expert group to coordinate the development of a regional framework including model legislation to address terrorism and transnational organized crime, and facilitated by the Pacific Islands Forum Secretariat.

III. STRENGTHS AND VULNERABILITIES IN THE FINANCIAL REGULATORY AND SUPERVISORY ARRANGEMENTS

A. Banking

21. As a new regulatory body, the FSC has not yet started its program of supervision of licensed financial institutions. The first major task for the FSC is the license application process preceding the granting of licenses under the new Banking Act. The Commission established a deadline of March 1, 2004 for the submission of applications, and at the time of the mission, was preparing for the review of applications received.

22. The FSC will be challenged to train its supervisory staff who, with the exception of the Commissioner, has no previous supervisory experience. The FSC also needs to develop a basic supervisory infrastructure including the development of regulations and guidance notes and on-site and off-site surveillance tools.

B. Anti-Money Laundering and Combating the Financing of Terrorism

23. The Cook Islands has recently developed a comprehensive suite of AML legislation but has not yet adopted CFT laws. Following the development of the AML suite of

legislation, regulations have been developed and were approved by cabinet during the mission. As with the regulation for licensed institutions, no adequate framework for assessing compliance with AML legislation is currently in place. Both the FSC and the FIU need to review their current resource levels against the compliance responsibility they have under the FTRA.

C. Key Concerns

International conventions/criminalizing the financing of terrorism

24. The Cook Islands have not ratified the Convention for the Suppression of the Financing of Terrorism and has not signed the Vienna or Palermo conventions. The financing of terrorism is currently not criminalized in the Cook Islands.

Resources

25. A number of government agencies face a constraint in relation to available human resources. These include the FSC, FIU, the SG's chambers, and the police. The availability of personnel with necessary qualifications and experience is critical if the Cook Islands is to achieve the status of a well-regulated OFC. The current dependence on foreign personnel resources is critical at present. However, over the medium term the government should emphasize, where feasible, the training of local staff to take over some functions currently undertaken by expatriates. Consideration should be given to ways in which other appropriately qualified persons might be attracted to work for these key government agencies.

Independence

26. The provisions of the FSC Act create a structure in which the regulator can have an adequate degree of independence. The Minister is limited to giving the FSC directions of a general policy nature and the FSC is, in theory, free to establish its own budget. However, at an operational level, the Commissioner currently involves the Board of the FSC in many day-to-day decisions. This practice creates a potential danger that the FSC's executive staff may not, for the foreseeable future, operate on a day-to-day basis without reference to the Board and, in so doing, may forfeit some of its operational independence.

Licensing of financial institutions

27. March 1, 2004 is the deadline for financial institutions to submit applications for licenses under the Banking Act. The FSC needs to develop a clear philosophy on the type of institution it wishes to license. Consideration will have to be given to the approach to be adopted in relation to international companies that apply for licenses.

28. The FSC will need to address the possibility that some international companies that currently hold banking licenses may continue to operate after June 1, 2004 without holding an appropriate license. The FSC will need to consider ways of publicizing the list of

institutions that are licensed to conduct banking business and issuing warnings where it discovers unlicensed institutions that continue to promote themselves as Cook Islands licensees.

Trustee Companies/International Companies

29. There is currently no effective mechanism for authorities to check on the due diligence performed on the approximately 800 international companies (ICs) that were registered at the time of the mission. The responsibility to undertake due diligence for these entities lies with the six trustee companies. However, while the FSC does have the legal authority to undertake compliance checks of trustee companies it does not currently do so and under its current initiative to strengthen its supervisory infrastructure, it will not develop this capacity. In addition, the Registrar of Companies does not have information on the beneficial owners of the ICs it registers, nor on the real activities of these companies.

30. The lack of adequate supervision of the trustee companies does not pose a direct risk to the CI as most ICs do not conduct business within the CI and CI financial institutions are obliged to undertake due diligence on all customers, including ICs. On the basis of anticipated applications for banking licenses, there will be a maximum of 11 banks in the foreseeable future, and the FSC is working to develop the capacity to undertake both on-site and off-site supervision of these institutions. However, in the non-banking sector, a significant number of companies will remain unsupervised and as these ICs are conducting business internationally, the real threat is to the international financial community. Countries with AML/CFT regimes that do not meet international standards could find their financial institutions establishing relationships with Cook Islands ICs for which proper due diligence was not undertaken.

Role of the private sector

31. While it is desirable for government authorities to consult with the private sector in developing the legal and regulatory framework for financial sector regulation and an AML/CFT regime, there should be a limit to such involvement. In the past, initiatives have been made to modify model legislation and other advice provided in a manner that significantly reduces their ability to mirror international standards. Recent regulations issued under the FTRA and some other issues highlighted in the report raise these concerns yet again.

IV. ASSESSMENT OF OBSERVANCE OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. General

32. This assessment of the Cook Islands' current state of compliance with the Basel Core Principles for Effective Banking Supervision was conducted as part of the IMF Module 2 Offshore Financial Center (OFC) assessment program. This report provides a key input for

the development of an action plan to move toward full compliance with the Core Principles. The assessors were Desiree Cherebin and Joel Shapiro, (Consultants, MFD).

Institutional and macro-prudential setting, market structure overview

33. The domestic banking system is comprised of branches of major Australian banks (ANZ and Westpac), and the indigenous Bank of the Cook Islands (BCI). The latter is the result of the merger, in 2001, of the government-owned Cook Islands Development Bank and the Post Office Savings Bank. While the bank will continue to be a stand-alone institution competing against the two Australian banks, it will no longer engage in development lending. Development lending will be transferred to a company affiliated by common ownership which will not be subject to supervision by the FSC. In addition, BCI will transfer its problem loans to another affiliated company.

34. The primary business of the domestic banks operating in the Cook Islands is traditional deposit taking and lending. Current data on total deposits and loans was not available from the Commission during the mission, but based on information provided by the three banks at meetings held with them, it is estimated that total assets in the domestic system aggregate approximately \$NZ 180 million, of which roughly \$NZ 150 million represents loans to commercial enterprises and consumers.

35. The offshore financial center (OFC) was established in 1981 through the enactment of several laws, which provided as a basic inducement, exemption from all forms of tax for all registered offshore entities. There are currently sixteen international banks licensed in the Cook Islands, which were granted offshore banking licenses under the Offshore Banking Act 1981, which was repealed with the Banking Act 2003. In addition, the Cook Island hosts some 800 international companies, and six trust companies that administer 2,100 international trusts. The trust companies act as representatives of some of the offshore banks. There are approximately 20 offshore insurance companies as well.

36. In June 2000, the Cook Islands were placed on the FATF's list of noncooperative countries and territories based on the absence of effective supervision of the offshore sector, the lack of an adequate infrastructure to combat money laundering, and excessive secrecy provisions. The government made some early progress in addressing the FATF's concerns, with the impetus fueled by the possibility of additional countermeasures by the FATF. More recently, the government has refocused on initiatives to upgrade its financial sector supervision and anti-money laundering infrastructure in its efforts to be removed from the FATF "blacklist," which is a high priority for government.

37. In May 2003, as part of this effort, the Government of the Cook Islands enacted legislation to establish the FSC as the sole regulator of the financial sector. The FSC is empowered, inter alia, to license, regulate, and supervise the business of banking. The effect of the legislation is to require offshore banks to have a tangible physical presence in the Cook Islands (the "mind and matter" principle), transparent financial statements, and adequate records prepared in accordance with consistent accounting systems. All will be subject to a

more vigorous and comprehensive regulatory process, including on-site examinations and supervision of their activities on a consolidated basis. The effect of the legislation and the supervisory processes to be implemented by the Commission may discourage some offshore entities from maintaining their operations in the Islands due, for example, to the cost of complying with regulation, issues of transparency, the size of their banking business, and other relevant factors.

General preconditions for effective banking supervision

38. Prior to enactment of the Financial Supervisory Commission Act, there was in practice no meaningful oversight and supervision of the financial sector. The Monetary Board, the predecessor to the Commission, was in fact cabinet and had long ceased to function as the regulator of the domestic banks. The Offshore Financial Services Commission viewed its principal role relative to the offshore community as a collector of license and registration fees.

39. The inadequate legal framework and the low level of resources devoted to bank supervision reinforced the conventional view that the banking system, especially offshore institutions, had free reign. There were no meaningful legal requirements pertaining to transparency, accounting standards, corporate governance, or safe and sound banking practice. There was no active on-site/off-site supervision program.

40. The new legal framework represents an important first step in correcting these deficiencies, as they are all addressed in the new set of laws. The framework empowers the Commission to license, supervise, and regulate the financial sector. It also provides it with enforcement authority in the event of noncompliance with the law, and to cooperate with foreign supervisors where necessary for implementation of comprehensive supervision on a consolidated basis. The second and more difficult task is implementation of these laws and creating the appropriate supervisory infrastructure, and that is the challenge that lies ahead.

B. Main findings

41. The suite of legislation enacted by the Cook Islands Government in May 2003, which included the Financial Services Commission Act (FSCA) and a new Banking Act, has created a strong legal framework under which financial institutions licensed in the Cook Islands are now required to operate. However, the main impediments to the implementation of the provisions of the legislation are resource constraints, mainly the inexperience of examiners, the absence of a comprehensive set of prudential statements, and the pace of development of supervisory tools. As a result, an effective supervisory framework, which meets the criteria of the core principles assessment methodology, is still to be implemented and the Commission will be severely challenged to have one in place by June 1, 2004 when the new licenses are issued.

42. Newly-recruited examiners need to be extensively trained. Prudential returns are yet to be developed, as well as systems for reviewing and assessing these returns. Examination

procedures still have to be introduced to enable the Commission to conduct annual on-site inspections of financial institutions as required by the FSCA.

43. In addition, the Commissioner's current practice of consulting with the board of the Commission on routine matters has the potential to undermine the Commissioner's independence and compromise effectiveness.

Principle-by-principle findings

Objectives, autonomy, powers, and resources (CPI)

44. The recently enacted Banking Act 2003 and the FSCA adequately set out the functions of the Commission including its supervisory responsibilities and enforcement powers, its authority to grant and revoke licenses, conditions for sharing prudential information with other regulators, and legal protection for supervisors for actions taken in good faith. Additional provisions for resolving problem banks, including the procedures for receivership and liquidation, would strengthen the legal framework.

45. The Commission has had to recruit its first Commissioner and Senior Supervisor from outside the jurisdiction on a contractual basis and is now seeking to fill the vacant post of Deputy Commissioner. The current lack of experienced supervisory staff coupled with issues of succession and sustainability are obstacles to the implementation of an effective bank supervision program and require the urgent attention of the Commission. A program to educate and compensate staff at a level that would encourage their retention, therefore, needs to be developed.

46. The Board of the Commission should also clearly define the responsibilities of the Commissioner, who should then ensure that there is no involvement of the board in day-to-day routine operational matters.

47. The Commission should develop procedures for the exchange of information with other supervisory authorities, especially since the two largest domestic banks are foreign branches and a number of the international banks may have operations in other jurisdictions. Procedures for sharing information with the FIU also need to be developed.

Licensing and structure (CPs 2-5)

48. Licensing requirements, as set out in the legislation, are good. The Banking Act 2003 and a Prudential Statement on Licensing issued in February 2004 set out detailed licensing criteria for both locally incorporated and foreign banks, including "fit and proper" criteria for shareholders and officers, satisfactory risk management, accounting and management control systems, and minimum capital requirements. All existing licensees grandfathered under the new act have to reapply for a license by March 1, 2004. The legislation also defines banking business, restricts the unauthorized use of the word "bank," and requires prior approval for changes in significant shareholding.

49. The test for the Commission will be how well the licensing criteria are implemented. The Commission has arranged technical assistance from PFTAC with the evaluation of the new license applications, including compliance with the new physical presence requirements for international banks. A challenge for the Commission will be dealing with entities that previously held banking licenses and are not re-licensed and any other unauthorized entities purporting to hold a Cook Islands banking license.

Prudential regulations and requirements (CPs 6-15)

50. The Commission has issued a detailed prudential statement on minimum capital requirements based on Basel I, which requires the risk-weighting of both on and off-balance sheet assets. It has also issued prudential statements on asset classification and loan loss provisioning and recognizes the need for other prudential statements to be issued pertaining to all areas of risk management. Apart from a capital adequacy return, the Commission still has to prepare and issue prudential returns and develop systems for monitoring and assessing all risks of licensees, including connected lending and related party transactions.

51. The Commission recognizes the need for the development of supervisory systems and procedures commensurate with the operations of licensees and has approached PFTAC for assistance in this regard.

52. The Commission also needs to give immediate attention to the development of on-site inspection procedures which facilitate an independent assessment of the risk management systems and internal control policies and procedures of licensees. A prerequisite to the implementation of an effective on-site inspection program is an intensive training program for examiners in risk assessment techniques.

53. The Commission also needs to work closely with the FIU in developing procedures for ensuring that licensees comply with anti-money laundering requirements.

Methods of ongoing supervision (CP 16-20)

54. The legal framework exists for the Commission to undertake on-site and off-site inspections. However, supervisory tools need to be developed, prudential statements issued, and examiners trained for the introduction of an effective on-site inspection program. Prudential returns, the development of analytical procedures, and appropriate staff training are also required for the introduction of a competent off-site function.

55. The Commissioner recognizes the importance of regular contact with the management of financial institutions and proposes to establish such a program.

Information requirements (CP 21)

56. The legislation requires financial institutions to maintain records, which accurately reflect their financial position and the appointment of an approved auditor. These provisions need to be complemented with a requirement that audited financial statements are prepared in

accordance with internationally accepted accounting standards and that approved auditors are members of recognized accounting bodies.

57. Procedures for the independent verification of the accuracy of the financial records of licensees also need to be implemented and the Commission should consider the use of external auditors in this regard.

Formal powers of supervisors (CP 22)

58. The Banking Act 2003 provides the Commission with a wide range of enforcement powers including the suspension or revocation of a license and the issuing of directives. These powers could be strengthened with the Commission being able to remove directors for abuse of power and incompetence and to impose fines for minor offenses.

Cross-border banking (CPs 23-25)

59. The Commission has the legal authority to effectively supervise the branches of foreign banks including sharing information with home supervisors. It now needs to develop working relationships with foreign regulators. Implementation of an approach to consolidated supervision must also be considered.

Table 1. Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
1(1) Clear responsibilities and objectives	<p>Provisions of law relating to problem bank resolution are not addressed fully in the law. The Commission’s enforcement action authority enables it to retain a court appointed manager to conduct or wind down the business of an institution. However, there are no specific provisions of law pertaining to receivership or liquidation proceedings.</p> <p>The Banking Act 2003 should be amended to add provisions specifically addressing these conditions, together with powers granted to the Commission in the event of a liquidity crisis.</p>
1(2) Resources	<p>The current hiring practices of the Commission, while appropriate for the early phase of its existence, raise questions of succession and sustainability at the Commission. A program must be developed to educate and compensate staff at a level that would encourage their retention, identify staff members who can assume leadership roles, and develop career paths for them. The Commission should explore creative ways under which senior staff can be attracted from the Cook Islands Diaspora, especially in New Zealand, as well as locally. It might, for example, consider offering more attractive remuneration packages to nationals from the Cook Islands Diaspora especially those locally and in New Zealand. In this context recruiting individuals presently working in the banking system should be considered. Filling vacancies on a contract basis with expatriates places management continuity and capacity at risk.</p>
1(2). Independence	<p>While it is recognized that the Commission is in its infancy, and that the Board and the Commissioner are establishing the framework for a working relationship, the Commissioner should not be in a position where routine operational issues are presented to the Board prior to or concurrently with action taken. The Board should be involved intimately with policy matters, but not in the day-to-day operations of the Commission.</p>
1(6). Arrangements for information sharing	<p>The Confidentiality and Disclosure provisions of the Banking Act 2003 and the FCSA are inconsistent and sometimes duplicative. Moreover, the existence of two different statutes separately criminalizing similar behavior is a potential problem, especially since the penalties are different. They should be harmonized. Sections 23(1) of the FCSA and 46(2)(g) of the Banking Act 2003, and Sections 20(3) of the FCSA and 47 of the Banking Act are those that differ in this regard.</p>

Reference Principle	Recommended Action
1(6). Arrangements for information sharing	While provisions of the law enable the Commission to disclose information to the FIU and to foreign supervisory authorities, no processes have been established to date governing the exchange of such information. While it is impractical to open communications in this regard with foreign supervisory authorities until the extent and nature of overseas operations of international licensed financial institutions are known, the process with the FIU should be accelerated to ensure it is in place when licenses are issued.
3. Licensing criteria	The Banking Act 2003 sets out criteria for the definition of a physical presence for international banks, and the Commission plans to verify that international banks awarded a license are in compliance with the provisions of the Act. The Commission should approach the verification process both as a compliance exercise and as a survey, the results of which should be analyzed for the purpose of publishing a prudential statement on the Commission's interpretation of "best practice" relating to physical presence.
3. Licensing criteria	The Commission will be challenged to ensure that unregulated institutions that may be operating a banking business are identified and "contained." One aspect of this is to ensure that those international institutions who have been operating under the previous legislative regime, and have indicated they will not apply for a new license to conduct a banking business, wind down their banking business and surrender their license. A comprehensive list of licensed financial institutions should be published in a manner that is readily accessible to the public, indicating that any other institutions purporting to be licensed with the Commission are operating in contravention of existing banking law. In the event the Commission becomes aware that an institution is conducting a banking business without a license, it should post warning notices, and where practicable, take legal action against the institution.
4. Ownership	The Commission is aware of the information required to assess a change in control or significant change in the ownership structure of a bank. However, there is no standardized medium through which such changes can be reported. To facilitate the reporting of these transactions and their analysis, the Commission should develop a standardized form to ensure communication of essential information.
6. Capital adequacy	The Commission's prudential return for the reporting and assessment of capital is satisfactory. However, there may be some confusion or difference in interpretation of certain off-balance sheet line items on the report. Definitions for off-balance sheet items are warranted to assure greater consistency in reporting.

Reference Principle	Recommended Action
7. Credit policies	There exists an appropriate legal framework for the Commission to supervise credit risk management. To complement existing law, the Commission should issue a prudential return requiring licensed financial institutions to establish written credit and investment policies, which govern the manner in which they manage risk, maintain credit administration practices, monitor and report exposures, and measure, control, ensure compliance with restrictions on large exposures, and connected lending relationships.
8. Loan evaluation and loan loss provisioning	Prudential Statement 3-2004, which provides guidance to licensed financial institutions on the classification of assets, provisioning for loan loss reserves and nonaccrual assets, must be amended to include classification and provisioning requirements for off-balance sheet items.
10. Connected lending	The Banking Act 2003 needs to be amended to include a comprehensive definition of “connected or related parties,” and to enable the Commission to use discretion in determining such relationships. The present definition excludes business interests of directors or shareholders and their families. The law also does not permit the Commission to use judgment about the existence of connections between the institution and other parties. Prudential returns should provide information on large exposures and connected lending relationships.

Reference Principle	Recommended Action
16. On-site and off-site supervision	<p>A legal framework exists that will enable the Commission to launch on-site and off-site supervision functions. To do so, the Commission must set a foundation. The foundation rests on a comprehensive training program for supervision staff, including the senior supervisor and the two junior supervisors. In addition, the Commission must issue prudential returns in a number of critical areas of banking activity and risk management to ensure that all licensed financial institutions adopt international best practice and are advised as to the nature of policy and practice that the Commission expects. Supervisory tools, such as an examination manual and examination report template, also must be developed, together with evaluation tools for such areas as credit, market, and liquidity risk.</p> <p>Core Principles 7, 11, 12, 13, and 14 all reflect an acute need for training of staff, issuance of prudential statements and the development of supervisory tools such as inspection procedures to build a competent on-site function.</p> <p>Development of prudential returns, training in analysis of financial institutions, and development of a technology platform to facilitate analysis of data is required in the building of a competent off-site function.</p> <p>The Commission should concentrate its resources on these critical areas in the near term, and delay implementation of a robust on-site examination program until many of these critical necessities are addressed. On-site examinations in the near term should be limited to targeted areas of an institution, and should serve the dual purpose of being a training exercise. Work of external auditors, once certification is ratified, should complement targeted examinations where the Commission has identified areas of risk, noncompliance, or other areas of critical interest.</p>

Reference Principle	Recommended Action
18. Off-site supervision	<p>The Commission is authorized to apply certain sanctions against a licensed financial institution in the event of noncompliance in providing information such as required in a prudential return. However, the law could be stronger in this regard, as noncompliance is not a punishable offense at present, and fines are not prescribed. Existing law should be amended to strengthen the sanctions available to the Commission to facilitate collection of accurate information in a timely manner.</p> <p>An automated system should be developed to facilitate the analysis of the international banking licensees. The Commission would be able to compare performance more easily, and identify trends and quantify differences in the banking business of this group. Such information would be a valuable tool in policy development and in developing supervisory strategies. The Commission should seek technical assistance in developing such processes.</p>
19. Validating supervisory information	<p>With the creation of the Commission, responsibility for registering approved auditors has been transferred to the Commission. As many of these auditors appear to have benefited from a “rubber stamp” approval under past practice, a re-registration process is warranted to update the current listing and enable the Commission to perform appropriate due diligence. Equally important, the Commission will be in a position to strengthen the ratification process where weaknesses have been identified.</p>
20. Consolidated supervision	<p>The Commission has virtually no knowledge of the overall structure of international financial institutions, nor has it considered the manner in which it will attempt to supervise material parts of these groups or how to evaluate the risks they may pose to the consolidated group.</p> <p>However, now is the time for the Commission to seriously consider the types of financial group structures that are desired for the Cook Islands, and communicate this vision, through a prudential statement, meetings with management and other media. The prudential statement should define comprehensive supervision on a consolidated basis, and the implications for licensees from the standpoint of their organizational structure, operations, and the quality and type of information that must be reported to the Commission.</p> <p>The Commission must have available financial and other information from a supervisory perspective on Bank of the Cook Islands Holding Corporation and its nonbank subsidiaries, both on a stand-alone and consolidated basis. The Commission’s supervision of Bank of the Cook Islands, Ltd. otherwise is constrained, and its supervision of the bank will not be on a comprehensive, consolidated basis.</p>

Reference Principle	Recommended Action
21. Accounting standard	The Commission should complement existing law pertaining to the appointment of auditors and their reporting requirements by issuing a prudential statement describing the criteria under which it will approve auditors, and that financial statements of licensees must be prepared in accordance with internationally accepted accounting standards.
22. Remedial measures	<p>While the Commission is empowered to employ a wide array of enforcement actions as part of its supervisory strategy related to an institution, it lacks the power to require removal of directors and officers for abuses of power or incompetence in the conduct of their responsibilities. The Commission also does not have the authority to impose fines. Existing laws should be amended to empower the Commission to take these actions where warranted.</p> <p>A prudential statement setting out a ladder of compliance, i.e., explaining the various actions to licensees that the Commission may employ also is advisable.</p>

Authorities' Response to BCP Assessment

Executive Summary, Key Recommendations, BCP:

60. **On Resources** where Report stated that “The Commission should explore creative ways under which senior staff can be attracted from the Cook Island Diaspora, especially in New Zealand, as well as locally”.

Comments: The Commission has tried to attract and retain qualified staff with limited success. Identification of staff members who can assume leadership role cannot be done at this stage when supervisors only started in early 2004. Performance evaluation after a reasonable period of time i.e. 6 months to a year will indicate the most qualified in the line of succession. Subsequently, career paths for the eventual take-over from expatriate staff can be developed after identifying their respective capabilities. To reiterate, filling vacancies with expatriates on a contract basis was a matter of necessity, not choice.

61. **On Independence** where Report stated that “The Commission should not be in a Position where routine operational issues are presented to the Board prior to or concurrently with action taken xxxx”

Comments: Relationships within organization are best left flexible to enable them to be tailored to fit the circumstances. The present consultation arrangement between the Board and the Commissioner works both ways and is most effective in the case of the Commission. The mere fact that the Commissioner refers to the Board some routine technical or administrative matters, does not, in any manner imply lack of independence.

While the Commissioner is experienced in her line of work, it should be noted that she is new in the Cook Islands environment and there is lack of technical support that can be relied on as “sounding board” for specific issues. To be more specific, handling purchases or hiring of staff that have been referred to the Board would enable the Commissioner to benefit from suggestions on how to proceed for “better quality and/or cheaper price” or provide some “feedback” on staff to be hired. Furthermore, having the Board consulted on specific issues enables members to be abreast of specific situations for a unified position on issues that may be brought to its attention.

62. **On Licensing** where Report stated that “ A comprehensive list of licensed financial institutions should be published in a manner that is readily accessible to the public xxxx. In the event the Commission becomes aware that an institution is conducting a banking business without a license, it should post warning notices, and where practicable, take legal action against the institution”.

Comments: At this initial stage of the Commission’s operations, publication of the list of licensed financial institutions (LFI) may result in more confusion and mislead the public. For banks and as suggested in the Report, publication will start immediately after the re-licensing process is completed and the number of licensed banks established. For non-bank LFIs i.e. Offshore Insurance Companies and Trustee Companies, the Commission has yet to develop and implement an appropriate licensing and supervision framework and once this is in place, publication will be made. The Commission will definitely institute post-warning notices and take legal action against institutions conducting banking business without a license.

63. **On On-site and Off-site Supervision** where Report stated the need for a comprehensive training program for supervision, the issuance of prudential requirements on a number of critical areas, the development of supervisory tools such as examination manual and report template etc.

Comments: The Commission’s original 2-year work program, a copy of which was provided to the IMF assessment team, incorporates most of the action needed as stated in the Report. Timing is the main issue considering existing constraints but the Commission has prioritized critical areas and developed a revised work program attached to this response. The existence and benefits, however, of training that has been provided and will be provided to staff for year 2004, (details in # 3 of attached revised work program), have not been given due credit. The Commission believes that the pacing and combination of on-the-job training delivered thru IMF technical assistance complemented by attendance in seminars/workshops, including attachment programs being arranged with PFTAC is best at this stage. Eventually, when we have a clearer picture of the industry and the “calibre” of staff, a comprehensive training program will be prepared to tailor-fit the Commission’s needs.

Recommended Action Plan to Improve Compliance with the Basel Core Principles

64. The **Commission** proposes to follow, in general, with the Recommended Action Plan. There are 2 major issues in the Report where the Commission takes exception and that refers to “Resources and Independence. This refers to situations where the Commission finds it difficult, if not impossible to comply such as overcoming resource constraints. Another contentious issue is independence of the Commissioner from the Board, which the Report censures with respect to referrals of day- to- day routine matters. The report generalized instances where routine matters were referred to the Board and painted a negative picture of the efficient working relationship. The acid test of independence for the Commissioner, is the ability to make decisions in accordance with legal and prudential requirements, after due consideration of available information and comments which may or may not be obtained from the Board.

65. A revised 2-years work program of the Commission pertaining to banking supervision, including what has been accomplished and what still needs to be accomplished in line with the response to this Report. This revised work program is attached to our covering letter.

Table 2. Authorities Action Plan

Reference Principle	Authorities Response
1 (1) Clear responsibilities and objectives	Will propose amendments to Banking Act 2003 to add provisions pertaining to receivership or liquidation.
1(2) Resources	If the IMF can suggest any creative solutions, these would be most welcome. The Commission made extensive enquiries and advertised locally, as well as in New Zealand and Australia when recruiting the Commissioner. We found out that there were very few people of any nationality from these 3 countries with experience in banking or financial sector supervision who were suitable or were at all interested. Life style as much as remuneration is a key factor. In addition, the free entry into New Zealand and lifestyle in the “big city” are very difficult attractions to offset. Nonetheless, the Commission will continue pursuing qualified staff from the Cook Islands Diaspora.
1(2). Independence	See comments under main text of “Authorities’ Response.”
1(6). Arrangements for information sharing	Will propose amendments to harmonize cited provisions of the Banking 2003 and the FSCA 2003.
1(6). Arrangements for information sharing	Will document initial “disclosure” and other arrangements with FIU when both institutions have been exposed to actual implementation issues. There exists in practice close coordination and cooperation between the FIU and the FSC and we do not see any

Reference Principle	Authorities Response
	<p>problem in handling specific situations or cases. Nonetheless, if technical assistance or a model document can be provided by the IMF or other authorities in this respect, the timing of the recommended action can be accelerated when licenses are issued.</p>
<p>3. Licensing criteria</p>	<p>Will issue a prudential statement on best practice relating to physical presence. Basic benchmark for best practice in this regard will follow Basel paper on “Shell Banks and Booking Offices” issued January 2003. Results of compliance exercise and survey will provide more specific inputs in developing the prudential statement on physical presence. Any “Model” definitions in this respect which the IMF can provide will enable the Commission to expedite action in this regard.</p> <p>Have initiated action on surrender of license for existing banks that have ceased or will have to cease doing banking business when its license expires on 1 June 2004. Letters sent in this regard. Likewise, these banks were also reminded of Section 52 of the Banking Act 2003 on the restriction in the use of the term “bank” etc. List of banks that have been licensed under Section 7 of the Banking Act 2003 will be published in the Gazette as required by law. Further comments on this issue are in the main text of the Response to Key Recommendations.</p>
<p>4. Ownership</p>	<p>A standard form will be developed.</p>
<p>6. Capital adequacy</p>	<p>Will issue clarification to Prudential Statement No. 2 on capital adequacy on definition of off balance items and other areas once first report due end of April are received and reviewed. Any “Model” definitions in this respect which the IMF can provide will enable the Commission to expedite action in this regard.</p>
<p>7. Credit policies</p>	<p>Will issue appropriate prudential statements and prioritize critical areas as may be determined during the evaluation process and subsequent on-site examination. More common risk management issues like credit and investment policies will be prioritized.</p>
<p>8. Loan evaluation and loan loss provisioning</p>	<p>Will amend Prudential Statements to include classification and provisioning requirements for off-balance sheet items.</p>
<p>10. Connected lending</p>	<p>Will propose pertinent amendments to the Act for more comprehensive definition of “connected or related parties,” and ensure that prudential returns provide information on large exposures and connected lending relationships.</p>

Reference Principle	Authorities Response
16. On-site and off-site supervision	<p>Comprehensive training of staff already started with a mix of briefing sessions, on-the-job training, attendance in a PFTAC sponsored seminar and participation in other training programs, including attachment programs to be arranged with PFTAC assistance and other sources. Further details regarding training are mentioned in the main body of the response relating to the Key Recommendations and Accomplishments cited in the revised 2-years Work Program.</p> <p>PFTAC will assist in development of prudential returns by June 2004 to be paced in starting the following month. IMF-TA being arranged by August 2004 for offsite supervision, including the establishment of a computer-based system for financial data and indicators. Supervisory tools on procedures, both for on-site and off-site functions are also expected to be completed by end of 2004. In the meantime on-site procedures of other supervision authorities in the region with similar set-up as the Commission will be used as guide by staff.</p> <p>It is acknowledged that a robust on-site examination can only be done when the necessary supervisory tools and staff skills are fully developed. In practice, this takes time assuming there are no major set-backs. There is no short cut to having an effective supervision system. Properly guided “learn as you work” approach is best under the current situation supported by “classroom” training and attachments, whenever these can be arranged. It is expected that IMF-TA expert will complement the training and guidance that to be provided by the Commissioner or other parties such as external auditors, contracted experts, etc.</p>
18. Off-site supervision	<p>Will review and propose amendments to strengthen the sanctions available to the Commission.</p> <p>This was addressed under in Principle 16. Developing offsite supervision monitoring system and supervisor skills in this respect is one of the areas where technical assistance has been requested even prior to the Assessment.</p>
19. Validating supervisory information	<p>As part of the license renewal process, the Commission will be checking that the existing or proposed auditor(s) meet the criteria specified in section 41. In due course, a prudential statement will be issued</p>

Reference Principle	Authorities Response
20. Consolidated supervision	<p>Consolidated supervision is not adequately covered by existing laws and amendments in this regard will be proposed.</p> <p>The Commission has no doubts on the need for consolidated supervision in situations where it is the home country supervisor or licensed bank's management and ownership are identical with holding company or other related companies. For this reason, details of the overall group structure of banks have been included in the requirements for licensing which was due after the Assessment. The 3 supervisors, under the guidance of the IMF expert and the Commissioner, are presently reviewing documents relating to group structures and will request for additional information and/or meet with applicant as may be necessary.</p> <p>On the Bank of Cook Islands Holding Corporation and its non-bank subsidiaries relationship with the Bank of Cook Islands, Ltd., the information requirements set in the recommended action may be included as a condition, should a license be granted.</p>
21. Accounting standard	<p>Will be included in the Prudential Statement to be issued with reference to Principle 19 on external auditors.</p>
22. Remedial measures	<p>Will propose amendments to strengthen enforcement action on the removal of directors and officers for cause and authority to impose fines. Action to be taken will also take into account Principle 18.</p> <p>Will consider issuing a prudential statement once Commission is more familiar with the types and scale of gravity for the various acts of "non-compliance" that should be matched with the ladder of compliance. Any "Model" which can be provided by the IMF in this regard will expedite preparation and issuance of the proposed prudential statement.</p>

V. REPORT ON OBSERVANCE OF STANDARDS AND CODES—FATF RECOMMENDATIONS FOR ANTI-MONEY LAUNDERING (AML) AND COMBATING THE FINANCING OF TERRORISM (CFT)

A. Introduction

66. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations for Anti-Money Laundering (1996) and 8 Special Recommendations Combating the Financing of Terrorism* was prepared by a team composed of staff of the International Monetary Fund, an expert under the supervision of Fund staff, and another expert not under the supervision of Fund staff who was selected from a roster of experts in the assessment of criminal law enforcement and non-prudentially regulated financial activities,⁸ provided by the Asia Pacific Group on Money Laundering.

67. The report provides a summary of the level of observance with the FATF 40+8 Recommendations, and provides recommendations to strengthen observance. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the Government of the Cook Islands or the Board of the IMF.

Information and methodology used for the assessment

68. In preparing the detailed assessment, Fund staff and the expert under the supervision of Fund staff reviewed the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter ML and FT among prudentially regulated financial institutions. In addition, Fund staff and the expert under their supervision reviewed the regulatory systems in place for non-prudentially regulated sectors that are macro-relevant, specifically, trust and company service providers. The expert not under the supervision of Fund staff reviewed the regulatory systems in place for other non-prudentially regulated sectors, specifically, money remitters, as well as the capacity and implementation of criminal law enforcement systems. The assessment is based on the information available at the time it was completed on February 26, 2004.

B. Main findings

69. **Overall, the current AML legal, institutional, and supervisory framework provides a sound basis for the prevention, detection, and prosecution of ML offenses, but implementation remains weak and FT is not addressed.** The Cook Islands authorities have devoted considerable effort to increase compliance with international AML/CFT standards, i.e., the FATF 40+8 Recommendations. The legal framework has substantially

⁸ The AML/CFT team included Mr. Peter Csonka (Senior Counsel, LEG) and Mr. Steven Gilbert (Consultant, MFD) as well as Mr. Simon Leung (Senior Inspector of Police, Hong Kong SAR) who was the Independent AML/CFT Expert (IAE). Throughout this report, portions of the assessment attributable to the IAE are shown in *italics*.

improved in 2003 with the passage of an AML suite of legislation, which included new acts on proceeds of crime (POCA), mutual legal assistance (MACMA), extradition (EA) and financial transactions reporting (FTRA). The CIG also reorganized the supervisory structure with the legislative establishment of the already operational FIU. While much of the necessary legal and institutional components for an effective AML/CFT regime are now in place, implementation in several areas, in particular regarding compliance supervision, remains weak and appears often to be driven by external pressure. Other significant shortcomings include the lack of criminalization of FT and the delay in the ratification of the relevant international treaties.

70. The Cook Islands authorities have strengthened the AML/CFT legal and institutional framework mainly in response to the FATF's listing of the Cook Islands as a noncooperative country in June 2000 and the findings of the APG/OGBS evaluation report. The Cook Islands has an offshore financial sector that licenses offshore banks and registers international companies. It also offers trust and company services, the main facility available under Cook Islands legislation being asset protection trusts. As the applicable legal, regulatory, and supervisory framework for AML/CFT exhibited serious deficiencies in the past, the Cook Islands was listed by the FATF in June 2000 as a noncooperative country. While under the new regime put in place in 2003, both the authorities and the financial sector began to improve the quality of AML/CFT measures to achieve conformity with the FATF 40+8 Recommendations, the efforts remain uneven. As the FATF has so far not found that the measures taken satisfactorily address the earlier identified deficiencies, it has not yet removed the Cook Islands from its list of Noncooperative Countries or Territories. An IMF Technical Assistance mission detected similar problems and made a number of recommendations to improve the AML/CFT framework.

Criminal justice measures and international cooperation

Criminalization of ML and FT

71. **The criminal law provisions for ML are in line with international standards and sufficient to prosecute offenses, but FT is not criminalized.** The Cook Islands has criminalized ML through Sections 280A and 280B of the Crimes Act 1969 (CA), as amended in June 2003. The principal ML offense (280A) conforms well with the requirements of the Vienna and Palermo Conventions: the actus reus covers a range of acts from conversion to possession and the scienter is broad, i.e., knowledge or reasonable suspicion. The ML offense applies to both physical and corporate persons and extends to all predicate offenses that are "serious offenses." The latter are defined by threshold, as a result of which any offense punishable under Cook Islands law by imprisonment of not less than 12 months or a fine of more than \$NZ 5,000, whether committed in the country or overseas, so qualifies. However, FT is not criminalized, and it is not a predicate offense for ML. To date, no charges have been laid for ML offenses, which seem to stem from lack of prosecutorial capacity and no focus on proceeds. The mission recommended strengthening capacity as well as some legislative changes, such as criminalizing expressly the laundering of one's own proceeds in Section 280A; including "willful blindness" among the knowledge standards; including

additional penalties for legal entities or professionals engaged in ML or FT (such as withdrawal of license or bar from exercising a professional activity); and enabling that the penalties foreseen for the ML offense under Section 280A may be combined.

Confiscation of proceeds of crime or property used to finance terrorism

72. **With the enactment of the Proceeds of Crime Act 2003 (POCA), the Cook Islands has put in place a sound regime for the forfeiture of proceeds and taking provisional measures, but it does not cover the freezing of terrorist funds and is untested in practice.** Under the POCA, tainted property and benefits derived from crime can be recovered through two different types of legal action, i.e., forfeiture orders and pecuniary penalty orders. Both are discretionary criminal penalties and require conviction of a serious offense. Forfeiture can be applied also against tainted property where the accused has absconded or died. Law enforcement authorities can use production orders, monitoring orders, and search warrants for tracing assets, and seizure and restraining orders can be used to secure them. To date, no property has been restrained, seized, or forfeited under the current legislation. As there exists no legislation providing for the freezing of funds or other property of terrorists, the authorities are currently not in a position to freeze such funds, etc. as required by the UN SCRs relating to the prevention and suppression of FT. The mission recommended that forfeiture be made mandatory for any serious offense where proceeds are detected and that legislation be adopted as a matter of priority to provide for the freezing of terrorist funds.

73. Legal provisions and protections for bona fide third parties are adequate.

74. *While the Proceeds of Crime Act 2003 is administered by Crown Law Office, there is no designated agency either overseeing the forfeiture program or keeping relevant statistics. Formal AML/CFT training is not available, but some training on an ad hoc basis is provided and funded by donor agencies on a regional level. The Solicitor-General, Commissioner of Police and the head of the Financial Intelligence Unit have attended various workshops and seminars on AML/CFT.*

The FIU and processes for receiving, analyzing, and disseminating intelligence at the domestic and international levels

75. **An independent administrative-type FIU has responsibility for the collection, analysis, and dissemination of financial intelligence** and is a key gateway in the information exchange concerning ML with foreign counterpart FIUs. Under Sections 10 and 11 of the FTRA, a broad range of “financial institutions” are required to submit ML-related reports to the FIU on suspicious transactions and cash and/or electronic transactions above \$NZ 10,000. The FIU has the authority to require reporting parties to supplement reports and has broad powers to obtain relevant information needed to combat ML, but it does not have FT-related functions at present. The FIU is able to exchange information with counterpart FIUs or like agencies without violation of secrecy provisions. Domestically, the FIU plays a central role in the Cook Islands AML regime, including training and compliance supervision

of non-licensed “financial institutions.” Egmont Group membership is expected to be granted in June 2004.

76. *The FIU keeps statistics on Suspicious Transaction Reports, Cash Transaction Reports, Electronic Funds Transfer Reports, Border Currency Reports, and intelligence provided by either domestic or overseas agencies. However, there are no statistics on cases referred to other law enforcement agencies and their results, nor requests made by or referred to a foreign agency. The FIU has so far received only a small number of STRs. Significantly, there have been no STRs since the enactment of the new legislation in June 2003.*

77. *The FIU has authorized staffing strength of 3, with only the head of FIU and the Intelligence Officer appointed. The position of the Compliance and Administration Officer is vacant. The Head of the FIU has extensive FIU and law enforcement experience from New Zealand and both she and the Intelligence Officer have received AML/CFT related training. Her current contract will expire in June 2004. The Intelligence Officer is due to leave the FIU and return to CIP in April 2004.*

Law enforcement and prosecution authorities, powers, and duties

78. *The Crown Law Office and the Cook Islands Police have primary responsibility for ensuring that ML offenses are investigated and prosecuted, but customs and tax authorities could also carry out related investigations. There has, however, so far not been any investigation or prosecution of ML. The Police are insufficiently equipped for financial investigations and they are not using the full range of powers and investigative tools available for combating money laundering and tracing proceeds of crime.*

79. Under the POCA, Cook Islands law enforcement authorities have various powers to compel production of bank account records, etc. as necessary to conduct investigations of ML and serious offenses. These include production orders, monitoring orders, and search warrants.

International cooperation

80. **While domestic law covers both mutual legal assistance (MACMA and POCA) and extradition (EA) matters comprehensively, the Cook Islands at present is not a party to the Palermo and Vienna Conventions, nor to the International Convention for the Suppression of the Financing of Terrorism**, though it has signed the latter. Under the MACMA and POCA, the Cooks Islands is able to provide a range of types of assistance without formal treaty or similar arrangements subject to dual criminality. It is not a party to any multilateral treaty in the area of mutual assistance in criminal matters. Domestic law (the UNSCRA) in principle also allows giving effect to Security Council Resolutions on FT, including SCR 1373, subject to issuing the necessary regulations, but none were so far issued. As regards extradition, the absence of criminalization of FT prevents the Cook Islands from extraditing persons sought for FT. This shortcoming has already been

identified and the authorities are planning to correct it with the proposed draft Terrorism Suppression Bill.

81. *The Cook Islands Police have been effective in following up informal requests for assistance through their own police networks. Records of each request received, and the response provided, are maintained in the Intelligence Office of the Cook Islands Police. The Crown Law Office is responsible for handling requests of mutual legal assistance. It has to date received one request. No requests were made to a foreign country nor requests received for registering a foreign forfeiture order in the Court of Cook Islands. Both the Crown Law Office and Cook Islands Police are able to cope with the present small number of requests.*

Preventive measures for financial institutions

82. **The establishment of the FSC and the FIU are extremely important first steps in the effort to improve the prudential regulation and AML/CFT oversight regime in the Cook Islands.** The FTRA and FSCA, as well as the Banking Act of 2003, establish a sound basis for the establishment of a competent regulatory authority and accompanying legal framework governing banking institutions, which represent an extremely positive development in the adoption of a sound and effective AML/CFT regime in the Cook Islands. However, these legislative efforts represent only the first, and possibly easiest moves, in the progress towards full FATF compliance. The authorities have prepared draft Guidance Notes on the Prevention of Money Laundering and Terrorist Financing in the Cook Islands (March 2003). However, they are not yet effective and are subject to further review and, thus, have not been considered in conducting the assessment.

83. However, there is strong concern with the more recent efforts to establish a firm regulatory regime to enable sound implementation of the legislative principles. While the laws themselves provide a basis upon which to launch effective measures to establish AML/CFT practices, the recently promulgated regulations may substantially weaken the key elements of the laws they seek to implement. The FTRA contains laudable provisions with respect to customer identification, verification, and required responses by financial institutions. The dilution of the customer identification requirements that are detailed in the FTRR on Customer Identification (CID), and exceptions provided in the Offering Company Regulations are in conflict with the clear and sound requirements established by governing laws. While it is clear that the laws take precedence, the relaxing of key components of the AML/CFT framework through regulatory alterations sends a confusing message regarding the intent of the authorities in this matter.

84. **Due largely to the newness of the legislation, as yet there have been few operational steps to implement comprehensive compliance and enforcement activities.** It is recognized that such measures will take time to develop and implement. At this time, other than domestic banking, the rest of the financial sector is either under lax regulatory regime or under no effective government supervision. For certain financial institutions subject to licensing requirements, including trustee companies and insurers, for example, the licensing requirement does not specifically refer to a fit-and-proper test. The laws which establish and

govern these institutions require updating in the same manner as was done for the banking legislation.

85. **The authorities have thus far played a minimal role in enforcing the AML requirements in the financial sector.** The offshore banking, insurance, and trust companies sectors are not currently subject to effective supervision by the FSC, while other covered entities, such as money remitters and moneychangers, fall outside any prudential regulatory regime and the responsibility for checking compliance falls to the FIU. Since the enactment of the FTRA, compliance by banks has been verified only by one on-site examination through the completion of a questionnaire developed by the FSC. There has been a request by the FIU for copies of the internal policies and procedures adopted by individual institutions for maintaining compliance with the FTRA, but as yet, none have been submitted and follow-up action will likely be required. Other than the single examination of a domestic bank, no other on-site verification has been carried out by either the FIU or the FSC. There has been no other on-site compliance checking. In other sectors, there have been no available resources to devote to ensuring the compliance of the AML requirements. The power of the FIU includes prescribing measures to financial institutions to ensure compliance with suspicious transaction reporting obligations. The authorities issued a number of implementing regulations under the FTRA during the mission's visit, though some needed updating. Going forward, further Regulations and Guidance Notes will need to be issued on key issues such as the provision of instructions relative to suspicious activities, protocol for "introduced business," regulatory requirements and treatment of business emanating from jurisdictions that do not have adequate AML/CFT regimes, vetting processes for employees in sensitive positions, the vulnerability of charities/nonprofit organizations, as well as measures to deal with CFT.

86. **Core arrangements for supervision and monitoring need to be developed, as the FSC is not presently able to verify compliance with the AML requirements by banks, trust companies, and insurers, nor is the FIU capable of executing its compliance audit responsibilities for other institutions.** The FSC, which regulates all licensed financial institutions, has devoted much of its modest supervisory resources toward developing a valid licensing regime consistent with its prudential regulatory responsibilities given under the FSC Act.

87. The FSC does not have the capacity to adequately supervise the work of the trustee companies. As a result, there is no effective mechanism for ensuring compliance by these entities in respect of the due diligence they undertake on nonbank international companies. This represents a threat to the international financial community as countries with AML/CFT regimes that do not meet international standards could find their financial institutions establishing relationships with Cook Islands international companies for which proper due diligence was not undertaken.

88. Besides capacity problems, there are certain legal provisions in Cook Islands law that may also create significant difficulties for the enforcement of FTRA-based AML/CFT measures in the area of international companies and trusts, e.g. by allowing to shield the

identity of beneficial owners of such trusts or companies or in some instances even the existence of trusts. For example, since the International Trust Amendment Act 1995-96, a potential litigant against an international trust is statute barred from even finding out whether the trust exists in the Cook Islands. Section 23 (2) of the International Trusts Act provides that proceedings against international trusts, other than criminal proceedings, must be held *in camera* and judgments exclude the names of interested parties. This could pose problems for the FSC when considering applications for the renewal of trustee company licenses and also for the FIU when gathering intelligence. Further, Section 26 of the same Act, as well as Section 224 of the ICA (and similar provisions in the International Partnerships Act and the Offshore Insurance Act) authorize the Minister of Finance and Economic Management to exempt any international trust, company, partnership or holder of an offshore insurance license from having to comply with any provision of the respective Acts. This includes the possibility of being exempted from the provisions of the respective Acts that require identification of the holders of bearer shares.

89. **The Banking Act provides the FSC to effectively regulate domestic and offshore banks; however, due to a lack of corollary legislation, all insurers and the trust companies operate under weak regulatory oversight and have not yet been the subject of any meaningful scrutiny.** The FIU and the financial regulators need to formulate a coordinated strategy for the on-site verification of the AML requirements in each sector. The compliance officer position within the FIU must be filled. There are no appropriate supervisory procedures applied to the offshore banking and insurance sectors; there has been no effective regime to supervise trust companies.

Other nonprudentially-regulated sectors (IAE)

90. *Money transmission services (Western Union) are not licensed, nor regulated in the Cook Islands, but they are subject to the FTRA obligations and have already made some CTRs.*

Summary assessment against the FATF recommendations

91. **The Cook Islands has achieved substantial progress in bringing its AML/CFT legislative and regulatory framework in line with the relevant international standards in a relatively short period of time.** That said, significant challenges remain as far as overall implementation is concerned, which impacts on the Cook Islands' compliance with the FATF 40+8 Recommendations. In summary, the Cook Islands complies only with those FATF Recommendations which focus primarily on legislative action apart from CFT, but does not comply with effective implementation on those matters.

92. As the vulnerabilities inherently linked with the offshore financial sector have not disappeared, the authorities must take priority actions in areas that include, but are not limited to: the criminalization of FT and the related extension of the preventive measures; ratification of the international conventions; enhanced compliance supervision; coordination of AML/CFT policy; consistency of the regulations with the FTRA;

development of additional guidance for the financial sector in the form of updated Guidance Notes; development and facilitation of compliance examination functions within the FSC and FIU; and further dialog with the private sector regarding the goals and needs moving forward with respect to AML/CFT.

Table 3. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
40 Recommendations for AML	
General framework of the Recommendations (FATF 1–3)	Ratify the Vienna Convention and ensure that domestic legislation is in place for its implementation.
Provisional measures and confiscation (FATF 7)	Make criminal forfeiture mandatory for any serious offense where proceeds are detected.
Customer identification and record-keeping rules (FATF 10–13)	<p>The conflict between the FTRR and the FTRA should be resolved as a matter of priority by eliminating any provision in the Regulations that diminishes the scope of the identification requirements set forth by the FTRA. Similar conflicts between the requirements of the FTRA and certain provisions in the area of company and trust law (ICA and ITA) area should also be reviewed and corrected as necessary (see examples in the report – paragraph 88)</p> <p>The FSC should undertake an initial process to determine whether banks have adequate record-keeping systems and procedures to provide assurance that compliance will be maintained.</p>
Increased diligence of financial institutions (FATF 14–19)	The FIU and FSC should open up further dialog with financial institutions to determine the level of understanding of suspicious activity concepts to identify potential gaps or bottlenecks in the process. Initiatives toward this end should also focus on clarifying what constitutes the tipping off of a customer.
Measures to cope with countries with insufficient AML measures (FATF 20–21)	The FIU and/or the FSC should issue the draft guidance notes that address enhanced scrutiny for countries that do not have adequate AML/CFT regimes.

Reference FATF Recommendation	Recommended Action
Implementation & role of regulatory and other administrative authorities (FATF 26–29)	<p>The government should introduce statutory fit-and-proper tests for directors, managers, and significant shareholders at the time of licensing/change in ownership of all regulated financial institutions similar to those contained in the banking law. In addition, the fit-and-proper test should be made an ongoing requirement.</p> <p>As part of the FSC’s overall development, it would be helpful to set forth a strategic plan specifically addressing AML/CFT issues to be included among the other supervisory initiatives it must undertake. This would include performing a risk assessment of regulated institutions to aid in the allocation/prioritization of examination resources, as well as key steps needed to develop appropriate supervisory guidance and procedures. This exercise could be conducted in cooperation with the FIU to enable the sharing of information, techniques, and resources.</p> <p>The level of resources in the FSC’s Supervisory Division should be assessed once the rationalization of licensing has been completed to ensure it has adequate human and other resources to carry out its supervisory and compliance role.</p> <p>The FIU’s Compliance Officer Position should be filled to ensure that all areas of risk related to the operation of licensed institutions are adequately covered.</p>
Administrative Cooperation— Exchange of information relating to suspicious transactions (FATF 32)	The basis and extent of cooperation of the FSC with other domestic authorities should be expanded in the FSC Act.
Other forms of cooperation—Basis and means of cooperation in confiscation, mutual assistance, and extradition (FATF 33–35)	Ratify the Vienna Convention and ensure that domestic legislation is in place for its implementation.
8 Special recommendations on terrorist financing	
I. Ratification and implementation of UN Instruments	<p>Ratify the ICSFT and ensure that domestic legislation is in place for its implementation</p> <p>Implement the UN SCRs on FT.</p>
II. Criminalizing the financing of terrorism and associated money laundering	Criminalize FT as a matter of priority and include it among “serious offenses” so that it is a predicate offense for ML.
III. Freezing and confiscating terrorist assets	Adopt as matter of priority legislation that provides for the freezing of terrorist funds and enables the effective implementation of UN SCRs on FT.
IV. Reporting suspicious transactions related to terrorism	Ensure, if necessary by issuing regulation, that the CIG regularly circulate UN and other terrorist watch-lists to financial institutions and keeps them abreast of new developments.

Reference FATF Recommendation	Recommended Action
V. International Cooperation	Ratify the ICSFT and ensure that domestic legislation is in place for its implementation. Implement the UN SCRs on FT.

93. Recommendations that are not directly related to compliance with FATF recommendations appear in Volume II.

Authorities' response

• Re UN Treaties and Conventions

94. The Cook Islands has sent its instrument of ratification the week of the 8th March 2004 for the Financing of Terrorism Convention and the instrument of accession for the Palermo Convention. Hopefully we will be in a position to advise you as to the specific dates of ratification and accession when we receive advice from the UN Treaty Section, sometime in the next couple of weeks. As to the Vienna Convention on Narcotics and Psychotropic Drugs, we will accede to the Convention when the legislation has been enacted.

95. "The IMF reported that the Cook Islands is not a party to the Vienna Convention and that was challenged by the PM. The Cook Islands is included by way of a territorial application clause in New Zealand treaty action when New Zealand ratified the Vienna Convention in 1987. Although the Cook Islands is bound by the Vienna Convention it is not a state party in its own right. Therefore the Cook Islands is not entitled to accede to supplements or subsequent Protocols of the Vienna Convention. Before the Cook Islands can accede to subsequent Protocols it must accede or succeed to the Convention. At present discussions are taking place between NZ and the Cook Islands to consider the best approach to take. Once an approach has been agreed, consultations will be held with the UN Treaty Section to resolve the present situation. One option has been proposed but the Cook Islands consider that there are other approaches that should be considered and these are being discussed."

96. We are in agreement with the IMF's draft report, and in particular agrees:

- (a) Subject to some minor amendments the suite of legislation passed in 2003 is generally good;
- (b) The regulations need to be reviewed as parts of them may be ultra vires the Acts they are made under;
- (c) Anti-terrorism legislation must be afforded priority;
- (d) It is too soon to determine whether the enforcement of the legislation is adequate.

97. We believe it inappropriate to regard the lack of a prosecution under the legislation as a negative factor. The Cook Islands offshore jurisdiction has a limited focus and if the number of international banking licenses issued is few and the core business remains

international trusts, there is a high likelihood the Cook Islands will be one of the least attractive jurisdictions to money launderers. Given the jurisdiction is small individual transactions are likely to receive more careful scrutiny from regulatory authorities and those few banks which provide international currency services than might be the case in larger financial institutions where the number of transactions make such scrutiny impracticable.

98. We appreciate the jurisdiction is absent a lengthy history of prudential supervision. The Financial Supervisory Commission has yet to be fully staffed and the IMF's 'wait and see' position is understandable in this context. The Society is concerned that the Commission's ability to draw from its income without limit is inconsistent with the general ethos for quasi-governmental agencies that fees should be paid to the public account and expenditure should be allocated by appropriation. In this way funding is allocated in accordance with need rather than income which may be no relation to what a particular public body requires to carry out its mandate.

99. Having said this we appreciate there is a greater need at this time—namely to satisfy the FATF that the Commission is absent any political influence and has no budgetary limitations on expending such funds as are necessary to properly carry out its functions.

100. Having noted the legislation is generally sound there is, as is pointed out by the IMF, some 'washing up' to do. In particular it is our view:

- (a) The provision in section 23 of the International Trusts Act 1984 which provides that unless otherwise ordered proceedings against international trusts, other than criminal proceedings, must be 'in camera' and judgments exclude the names of interested parties should be modified so that this restriction does not apply to the Commission. By way of example one case in the High Court involved a trust established by settlors who made their money from an illegal ponzi scheme in the U.S.A. The settlors were successfully prosecuted by the FTC and settled the trust as a result of the judgment. It is in our view relevant for the Commission, which considers applications for renewals of trustee company licenses, and possibly the FIU which gathers intelligence, to be privy to such information.
- (b) The provision contained in section 26 of the International Trusts Act 1984, section 224 of the International Companies Act 1981-82 ("ICA"), section 77 of the International Partnerships Act 1984 and section 23A of the Off-shore Insurance Act 1981-82, allowing the Minister of Finance and Economic Management to exempt any international trust, international company, international partnership or holder of an offshore insurance license from having to comply with any of the provisions of their respective Acts, has potential to defeat the 'spirit' of the FATF's objectives. For example, the ICA, following a recent amendment, requires the identification of the holders of bearer shares. However, the Minister may exempt any international company from complying with this requirement. It is the Society's view that the Ministerial exemption should either

be abolished or truncated so it can only be granted in limited specific cases where only minor issues of administrative compliance are involved.

- (c) At present, a potential litigant against an international trust is statute barred from even finding out the fact that trust exists in the Cook Islands. In the Society's view this has taken the confidentiality provisions too far and the requirement in place before the passage of the International Trusts Amendment Act 1995-96 that trustee companies display a list of the trusts they provide a registered office for be restored, with perhaps the practical modification that such list not have to be displayed but must be available for the public to inspect during normal working hours.
- (d) While the 'offshore' legislation now appears 'state of the art', the legislation relating to both domestic and offshore insurance has not been repealed or amended. It is the Society's view a review of this legislation is necessary to 'complete the package'.
- (e) While legislation later in time generally overrules legislation earlier in time where there is an inconsistency, the provision in section 20(15) of the Financial Supervisory Act 2003 providing specifically for this, and the absence of such provision in the Financial Transactions Reporting Act 2003 has the potential to cause uncertainty. The Society believes this potential ambiguity would be dealt with if a similar 'paramount' provision was inserted in the latter Act.

101. On page 9 of Volume I of the IMF Report there is reference to Class A, B and C licenses. It is not clear from the Report whether this is stating the contemporary or historical position. This is important because that regime of licensing was abolished with the passage of the Banking Act 2003.”

Analysis of Effectiveness (re Part F, Section III – pages 56 and 57, Vol II)

102. We agree with the recommendation that the definition of Financial Institution be narrowed to cover “reporting” institutions (which we assume to be Licensed Financial Institutions). There is significant confusion currently over the ambit of the current definition and some additional clarity would help resolve that.

Assessing Preventative Measures for Financial Institutions (re section II – pages 69-71, Vol II)

103. The IMF obviously appeared concerned over the acceptance of transactions with regulated financial institutions (“RFI’s”). Our understanding of the rationale behind this was, rather than to subvert the rules, this merely sought to reflect the reality that where

transactions are undertaken with RFI's in FATF approved countries, those RFI's would already hold the KYC required by the territories' laws, and would be obliged to report suspicious and threshold transactions. Therefore as customer ID was held at the RFI level this ought to constitute sufficient verification and no duplication of process was necessary as the concern here (i.e. world-wide ID of participants in financial transactions) was already addressed.