

I. INTRODUCTION

1. This report provides the findings of the Module 2 assessment of the Turks and Caicos Islands. The report is organized in two volumes. Volume I provides an overview and the summary findings. Volume II provides the detailed findings of the assessments of compliance against the Basel Core Principles for Effective Banking Supervision, the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS), and the Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Standards.

2. Volume I is organized as follows: Section II provides an overview of the financial system and the regulatory and supervisory framework and Section III summarizes the findings on the strength and vulnerabilities in the financial system.

II. OVERVIEW OF THE FINANCIAL SYSTEM

A. Background

3. The Turks and Caicos (TCI) is an Overseas Territory of the United Kingdom. The islands form the south-eastern extremity of the Bahamas chain. They lie 145 kilometers north of Haiti and the Dominican Republic and 925 kilometers southeast of Miami. The territory comprises some 40 islands with a total land area of 500 square kilometers. The estimated population of TCI is 20,000. The GDP per capita in 1998 was estimated to be \$6,000 with an estimated growth rate of 5 percent. Tourism and offshore finance are, in that order, the two main sectors of the economy.

4. TCI is a “zero tax” jurisdiction. It has no income, capital gain, wealth, gift, or inheritance tax. TCI has no tax treaties with any other jurisdictions. The major sources of government revenue include stamp duties, customs receipts, and fees from offshore financial activities. The U.S. dollar is used as the local currency. TCI has no central bank or monetary authority. There are no restrictions on movement of funds into or out of TCI.

B. Financial Services Sector

Financial sector structure

5. The Turks and Caicos provides a range of financial services, including banking, specialized insurance, trusts, and corporate structures. Although few statistics are available to measure the size and performance of the financial sector, some key characteristics are evident. Incorporation and licensing of producer-owned reinsurance companies is the most dynamic portion of TCI offshore financial business. The banking business has been static in recent years and is undergoing consolidation. The financial sector is small in international terms but significant in terms of the local economy. The vast majority of transactions are conducted with and between nonresidents. Many banking clients have an economic attachment to the island. The structure of the financial sector is as follows:

- As of the end of September 2002, there were eight licensed banks of which six were national banks and two were offshore banks with no banking operations in TCI. Three banks conduct a largely retail banking business and account for the bulk of bank assets and deposits. Total bank on-balance sheet assets were \$480 million. Foreign exchange exposure is very limited given the use of the U.S. dollar as the local currency. TCI banks generally do not engage in derivative transactions. The largest bank, the TCI branch of Barclays Bank, accounts for more than half of all banking assets. Branches of two Canadian banks also provide retail services. Two smaller banks specialize in private client business and one specializes in wholesale banking in TCI. The two offshore banks carry on banking business in Panama and Venezuela, respectively.
- Since September 2002, the branches of Barclays Bank and of CIBC have merged and restructured as TCI subsidiaries of a jointly owned Bahamas bank holding company. The branch of the Bank of Nova Scotia is in the process of restructuring as a TCI subsidiary of a Bank of Nova Scotia bank holding company in The Bahamas.
- As of end 2002, 3,013 licensed insurance companies, of which: 2,857 are credit life, extended warranty, and mortgage guarantee PORCs; 143 are captives; 8 are local direct writers of general insurance; and 5 are long-term insurance companies. No statistics are available on the total assets of the insurance sector, nor are indicators of financial performance available. TCI has a niche specialization in PORCs. These companies, typically owned by U.S. retailers, provide reinsurance for credit life and product warranty insurance. The insurance is underwritten by a U.S. direct writer, who in turn reinsures all or most of the risk with the TCI reinsurance company owned by the producer of the business.
- There are 22 licensed trustees, 5 of whom hold restricted licenses and 17 hold nonrestricted business. Trusts in TCI are understood to be used primarily for estate management and tax-efficient structures for private rather than institutional clients.
- There are 30 licensed company managers primarily supporting the incorporation and management of offshore companies registered and licensed in TCI.
- There is one licensed mutual fund.
- There are 17,755 companies, including 13,952 exempt companies that are not permitted to do business in TCI and 3,509 ordinary companies. In addition, there are 199 foreign companies, 75 limited-liability companies, and 20 limited partnerships. No information is collected on the business activities of exempt companies, but many are understood to be asset-holding vehicles for both corporations and individuals. PORCs account for 22 of the exempt companies.

TCI legal framework

6. TCI is an internally self-governing overseas territory of the United Kingdom with a ministerial system of government. The government is run through a governor appointed by the Crown, and executive and legislative councils. The governor retains responsibility for internal security, external affairs, defense, the public service, and (importantly, in the context of the OFC assessment) offshore finance. The governor appoints the judiciary, as well as the attorney general and the chief secretary. The governor retains responsibility for offshore finance and, under legislation adopted in 2001, the FSC reports directly to the governor. The legislature consists of 19 persons, of whom 13 are elected.

7. The executive arm of government is the executive council, consisting of 9 members, including the governor, 6 ministers, and 2 ex officio members (the chief secretary and the attorney general). The chief minister is also the minister of finance, development, and commerce.

8. The TCI legal system is based on the English model, but unlike England, it has a written constitution that includes provision for the protection of fundamental rights and freedoms. Most of the law derives from ordinances passed in the legislative council and, to a lesser extent, from legislation specially extended to TCI by the United Kingdom. To the extent statutory law does not apply or requires interpretation, the common law applies.

9. The court system comprises the magistrate's court, supreme court, court of appeal (all of which sit in TCI), and the privy council in London as the final appellate body. The supreme court is vested with the same jurisdiction and powers as the high court of England. The legal profession is represented by a statutorily constituted bar association.

Supervisory structure

10. In May 2002, the FSC was established as a statutory body responsible for financial supervision in TCI. Prior to that, the FSC had been a department of government within the ministry of finance. As a statutory body, the FSC has a board of directors composed of 7 to 9 persons, including the permanent secretary, finance, and the managing director of the FSC as ex officio members, with the other directors appointed by the governor. Under the Financial Services Commission Ordinance 2001, executive responsibility for licensing and supervision is exercised by a licensing committee. The licensing committee is comprised of the ex officio members of the board of the FSC and one or more board-nominated appointed members.

11. The FSC acts as a single regulator responsible for licensing and supervision of all institutions licensed under TCI financial legislation. The FSC Ordinance 2001 transferred to the FSC responsibility for administering financial supervision ordinances, but it did not significantly alter requirements under those ordinances. Those ordinances cover banking, insurance, trusts, trustees, mutual funds, investment dealers, company managers, and company registration, and provide for a superintendent for each function. Each supervisor is accountable to the board of the FSC via the licensing committee.

Legal and institutional framework for anti-money laundering

12. Adoption of the Proceeds of Crime Money Laundering Regulations (PCMLR) in 1999 created a sound legal basis for the AML/CFT regime by setting out fundamental requirements for the regulated sectors to establish and maintain procedures for customer identification, record-keeping, internal reporting, as well as employee training. While the regulations do not create a positive duty to report suspicious transactions (STRs), the AML obligations are underpinned by an offense of failing to have these procedures and training set up and maintained.

13. The PCMLR are supported by AML nonbinding guidance notes issued jointly by the FSC and the MLRA, the latter being designated under the PCMLR as the body that receives STRs. However, the MLRA is not an operational body and does not meet the requirements of the Egmont Group to qualify as an FIU. Given the lack of a centralized financial intelligence agency, the financial crimes unit of the police deals with STRs and investigates money-laundering offenses.

14. Several overlapping statutory provisions criminalize money laundering. Comprehensive provisions exist for the confiscation or forfeiture of proceeds of crime, but they are limited to value orders. The TCI does not have a civil forfeiture regime. An amendment to the PCO in 2001, the PCODCTO, enabled the recognition and enforcement by TCI of overseas confiscation orders made in one of the designated countries or territories. To help investigations into ML and FT, production orders are available, but account-monitoring orders can only be used for FT investigations. Professional privileges enjoyed by lawyers are relatively broad and may impact adversely on ML investigations.

15. The financial crimes unit (FCU) of the criminal investigations division (CID) is the primary law-enforcement agency with responsibility for receiving, analyzing, and investigating all serious financial crime. The unit also receives and investigates suspicious transactions reports (STR) as well as foreign requests for assistance. Investigations are carried out by the FCU, which has very good working relations with the attorney general's chambers, other law-enforcement agencies, the banks, and other financial institutions, as well as foreign law-enforcement agencies. Cases reviewed indicate that the FCU has had notable success in combating money laundering, including by providing valuable assistance to overseas authorities. Intelligence gathering and cross-border information exchanges would be improved significantly by creation of a formal FIU and participation in the Egmont Group.

Organization of the financial services commission

16. The FSC currently has staff of 17 persons with an additional 5 positions currently vacant. The managing director has administrative responsibility for FSC and is also the superintendent of banking and mutual funds. One technical assistant and an administrative support person report to the managing director, but neither has professional responsibility for supervisory matters. The deputy managing director is also the superintendent of trustees and of company managers with no staff currently assigned specifically to support his supervisory

functions. Insurance supervision is carried by the superintendent of insurance (SOI) assisted by one administrative officer and one clerical assistant. Seven staff, including the registrar of companies, are engaged in companies' registration. The registrar of trade marks is assisted by one staff. Legal support is provided as needed by the attorney general's chambers.

17. The FSC Ordinance provides that the FSC will be funded by fees, charges or penalties payable under the financial services ordinances. This section of the Ordinance has not been enacted. Under transitional arrangements, FSC is being funded by subventions from the government budget. Pending clarification of government policies with respect to the allocation of revenues generated from fees paid by the financial sector, FSC's budget is determined by the government. Employee compensation rates are also subject to government approval and generally aligned with civil service salaries. Staff recruitment has been slow and turnover at the senior levels high, reportedly because salaries for qualified staff are noncompetitive. The budget proposed for FY 2003/04, but yet to be approved, includes the authority to fill six positions.

18. Under the FSC Ordinance, executive responsibility and decision-making authority are vested in the licensing committee, which meets approximately once per month. In addition to the granting and withdrawal of licenses, the licensing committee is responsible for virtually all nonroutine supervisory matters, including decisions on the scope of examinations of individual firms, proposed regulations or guidance to the industry, and matters related to cooperation with other authorities. At present, 3 non-ex officio members of the licensing committee are practitioners active in the financial industry. The committee has a clear disclosure of interest policy requiring members with an interest in a matter under discussion to recuse themselves from participating in those matters. The recusal requirement is invoked frequently.

19. Decisions by the licensing committee are transmitted to the board of directors for confirmation. As a matter of practice, the licensing committee refers significant decisions to the executive council for clearance. The board exercises policy oversight of the FSC, including the licensing committee, and is accountable to the governor. Under the FSC Ordinance, the governor has express authority to exempt parties from licensing requirements, to instruct FSC to investigate a licensee, or to exchange information with overseas authorities.

20. Outside the company registration function, day-to-day operations of the FSC staff are diffused across numerous activities. Work of the insurance staff focuses mainly on routine licensing of new firms and administration of filings and fee payments by licensed insurance companies. Drafting of implementing regulations and guidance for new financial legislation, which falls to the individual functional superintendents, has been halting and standardized operating procedures remain to be developed for most supervisory activities. On-site prudential examination of banks is limited in scope and unsystematic. No program of on-site examinations of insurance licensees has yet been initiated, and on-site examination of other nonbank licensed firms is very limited. Bank returns are subject to a new program of off-site

monitoring of quantitative returns. Reviews of filings by insurance firms, as well as those of trust companies and company managers, appear to be limited.

21. The FSC has not been given explicit responsibility for ensuring compliance with the anti-money laundering regulations, but it does oversee this as part of its general responsibility for regulatory compliance by licensed firms. Targeted examination for AML/CFT compliance is in abeyance pending recruitment of a compliance officer.

Recent regulatory developments

22. Over the past two years, in response to international pressures, major changes have been introduced in the financial supervision regime in TCI. Many of these changes are direct responses to the KPMG report,⁴ issued in October 2000. Among other things, that report recommended that FSC be given operational independence and its authority strengthened. The report recommended that FSC's operating practices with respect to prudential supervision be strengthened and professionalized, that supervisor's access to client information be liberalized, and that compliance with AML requirements be systematically monitored and enforced. The report contained numerous recommendations requiring new legislation or amendments to existing ordinances.

23. In response to the KPMG report on February 8, 2001, the TCI government undertook to introduce new legislation, or to amend significantly existing legislation related to the supervision and regulation of banking, insurance, securities, trustees, mutual funds, and company service providers. In addition, the TCI government undertook to establish a formal framework for monitoring compliance with TCI's Proceeds of Crime (Money Laundering) Regulations. Not all the recommendations in the KPMG report were accepted, nor were all addressed in the initial legislative program. The government anticipated that further measures would be introduced following an initial phase of reforms. Since the KPMG report, no less than 22 individual pieces of financial sector legislation, regulation, or guidance have been adopted by TCI.

III. SYSTEM WIDE REGULATORY ISSUES

A. Supervisory Independence

24. Establishment of FSC as a statutory body has not achieved the operational independence recommended by the KPMG report and called for by international standards.

25. Private practitioners active in the financial industry constitute a majority of both the board of directors and the licensing committee, posing the risk of regulatory capture. This

⁴ The Turks and Caicos was one of the subjects of the *Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda* prepared for the United Kingdom by KPMG, October 27, 2000 (The KPMG Report).

issue is particularly concerning with respect to the licensing committee, which plays a central role in licensing and supervision decisions. This governance structure, combined with FSC staffing weaknesses, unduly diminishes the authority of the managing director and the professional staff of FSC. Recusals by board and committee directors are common, reflecting the frequency with which these bodies take up issues touching on directors' interest. Even where no conflict of interest exists, privileged access by private board and committee members to competitive information is a concern for a small financial community like that in TCI.

26. While it is appropriate that the board of directors of FSC be ultimately accountable to the government or the governor, it is disconcerting that the governor retains authority to give instructions to the FSC on key matters. More troublesome is the active influence over FSC operations that is exercised by the government via budgetary restrictions and through the practice of vetting key licensing committee decisions by the executive council.

27. To achieve more effective FSC operational independence, the mission recommends that:

- currently active private practitioners be limited to a minority of the positions on the board of directors and excluded from the licensing committee;
- consideration be given to inviting experienced nonresidents to join the board and serve on the licensing committee—a practice that is followed in the Crown Dependencies;
- alternatively, consideration should be given to abolishing the licensing committee and replacing it with a strong executive committee under the managing director, who would report to the board for policy and budgetary matters;
- the provisions of the FSC ordinance regarding funding of FSC through fees paid by the financial sector should be implemented based on a formal arrangement between the government and the FSC, which insures that FSC receives a share of the fees paid by the financial sector adequate to fund supervisory practices that meet international standards.

B. Implementation of Financial Supervision

28. Recent legislation has substantially enhanced the TCI legal framework for financial supervision. Implementation of that legal framework, however, needs to be strengthened substantially.

29. As noted, the governance structure of FSC lodges executive decision making in a non-executive licensing committee, a majority of whom are active practitioners in the TCI financial industry. This structure provides little autonomy for the managing director and professional staff of FSC and inhibits supervisory initiative. Financial ordinances give FSC only weak enforcement powers with sanctions largely limited either to revoking a license or

to pressing criminal charges. Direct political interference in FSC operations does not appear to be a problem, but inadequate and unreliable funding have undercut the FSC's ability to recruit and retain staff, and to initiate supervisory initiatives not anticipated in the barebones budget until-now authorized.

30. The FSC staff devoted to ongoing supervision, as distinct from routine licensing and registration, is inadequate. Many basic supervisory functions are being neglected or left incomplete because of staff turnover or lack of staff. Implementing regulations and supervisory guidance have yet to be developed for much of the new financial legislation. No systematic monitoring of the TCI financial sector for compliance with AML/CFT requirements is being carried out and regulatory compliance more generally is inadequately checked. Prudential regulation of banks requires more time and attention than the banking superintendent can provide, given her primary responsibility as managing director for the administration of FSC. Middle management and technical skills need to be augmented.

- The vacant position of compliance officer should be filled with a qualified professional as a matter of immediate priority.
- The additional 5 staff proposed in the budget should be recruited by mid-2003.
- Day-to-day responsibility for banking supervision should be delegated to a qualified professional with adequate staff support to carry out on- and off-site supervision at the standard called for in the Basel Principles.
- The FSC should be organized along functional lines independent of the statutory requirement for individual superintendents to be assigned responsibility for administration of each financial ordinance.
- Financial ordinances should be amended to give FSC powers to impose graduated administrative sanctions consistent with the severity of the issue in order to ensure compliance with supervisory requirements.
- Given the time necessary to implement structural changes, as an interim measure, FSC should consider using its authority to appoint investigators to engage one or more qualified contractual examiners to begin to carry out targeted AML/CFT compliance examinations. Similarly, in order to bring supervisory practices quickly up to international standards, FSC should consider ways to create greater synergies with the external audit work that is already being conducted in licensed firms.

C. Implementation of the AML/CFT Regime

31. The institutional arrangements for AML/CFT are not yet fully in place and so far chronic shortage of staff at all levels and lack of adequate powers have prevented effective regulatory enforcement in this area. The relevant institutions include (1) the FSC, which has regulatory and supervisory oversight but lacks clear legal grounds to enforce AML/CFT

Regulations, as well as staff and enforcement powers, for example, to order sanctions for failure to implement AML/CFT obligations (only the attorney general can do); (2) the police, whose financial crimes unit has responsibility to analyze STRs and investigate into ML and FT, but has limited intelligence gathering capability; (3) the MLRA, which, though designated as the body that receives STRs, functions more as an informal coordination group; (4) the attorney general's chambers, which prepare legislation, prosecutes ML and FT, assists in obtaining production and restraint orders as well as assistance to overseas jurisdictions; and (5) customs, which controls cross-border cash movements. TCI courts (magistrate's court, supreme court), also take part in the enforcement of the AML/CFT regime, mainly by issuing compulsory orders on application by the attorney general.

32. The coordination of these various institutions is ensured by the MLRA, but no policy initiatives have been taken by this group since its inception in 2001. Legislation is comprehensive, but needs consolidation and updating in several key areas.

33. Despite significant progress achieved over the past few years, the TCI remains exposed to the risk of being misused for ML and FT. In general, the AML/CFT regime seems to react to external pressures rather than to genuine local strategy. Since the TCI is an offshore jurisdiction, the MLRA should collectively analyze the vulnerabilities of the TCI, in particular, those related to the corporate facilities offered by the jurisdiction, and keep the overall AML/CFT regime under review to ensure its effectiveness. Another key to the implementation of the AML/CFT regime is the setting up of an operational FIU with access to all relevant information. Adequate staffing and resources of the FSC for enhancing its AML on-site inspections, as well as empowering it to have access to the supervised institutions customer's files and to impose regulatory penalties as necessary are other essential issues that the TCI needs to address.

Authorities' Response: System-wide Regulatory Issues

Independence of the Financial Services Commission

The Authorities in the Turks and Caicos Islands have noted IMF concerns in respect of the appointment of active practitioners in the financial services industry on the Board of the Financial Services Commission and your recommendations that consideration be given to non-residents being appointed to the board and serve on the licensing committee, or alternatively abolish the licensing committee and replacing it with a strong executive committee under the Managing Director.

Whilst we concur there is a need for vigilance, where board members who are practitioners in the industry interests conflict with their duties as directors of the Board, there are safeguards in the Financial Services Ordinance to mitigate this risk.

Section 23 of the Ordinance makes it a requirement that a director who has any direct or indirect personal, professional, business, or pecuniary interest in any matter to be considered by the board shall, after the commencement of a meeting at which the matter is to be

discussed and before that matter is considered by the board disclose the nature of his interest to the board. A director who fails to disclose an interest shall be guilty of an offence and liable on summary conviction to a fine of \$10,000 and, on conviction on indictment, to a fine of \$50,000.

We have liaised with the industry whose interests are at risk concerning the present composition of the Board and the Licensing Committee and the industry has confirmed that it has confidence in the Board of the FSC and the appointment of the current members to serve on the Licensing Committee.

We are conscious, however, that not only that there should be no conflict of interest, but that there must also be an appearance of no conflict of interest on the part of the Licensing Committee of the FSC. In this regard we will take the appropriate measures to remedy any appearance of conflict of interest.

With regard the financial provisions for the funding of the FSC the Government has always given assurance that the Commission will be adequately resourced. To achieve greater transparency the government has now undertaken to put in place a formal arrangement based on the provisions in the Financial Services Ordinance. In this regard budget projections and FSC's Corporate Plan for the year 2003/2004 were based on their decisions to make funding more transparent.

The projections include the following:

- Recruitment of a Bank/Trust Examiner to carry out examination of the financial institutions in the Islands;
- Recruitment of a Deputy Superintendent of Insurance to assist in the supervision of the industry and carry out on-site inspection of companies licensed under the Insurance Ordinance;
- Recruitment of a Superintendent of Mutual Funds and Collective Investment Schemes;
- Recruitment of a Compliance Officer to carry out compliance checks in the industry as part of the supervisory team of the departments in the FSC and under the provisions of the Proceeds of Crime Ordinance.

The FSC has, since the publication of the draft report, appointed a Bank Examiner and a Compliance Officer as part of its established complement of staff.

IV. SUMMARY OF OBSERVANCE OF FINANCIAL SYSTEM STANDARDS AND CODES

A. Basel Core Principles for Effective Supervision

General

34. The following is a summary of an assessment of compliance by the Turks and Caicos Islands with the Basel Core Principles for Effective Supervision (BCP), which was carried out February 3–14, 2003, in the context of the IMF Offshore Financial Center (OFC) program. The assessment used the Basel Core Principles Methodology document and was prepared by Mr. Marcel Maes, Banking Consultant, MFD, assisted by John Abbott, MFD.

35. The assessment was based in part on an FSC self-assessment of compliance with the Core Principles. The mission reviewed relevant laws and regulations, interviewed staff of the FSC, and held discussions with representatives of the financial industry. The mission would like to acknowledge the excellent cooperation and assistance received from the staff and management of the FSC and the financial sector representatives.

Institutional and macroprudential setting, market structure—overview

36. Section II above provides an overview of the financial market structure in TCI, including the banking sector, and the institutional arrangements for financial supervision. Section III discusses system-wide issues. Given the small size of the financial sector and the role of FSC as a single regulator, that material also provides the background for the detailed assessment of the supervision of banks.

General preconditions for effective banking supervision

37. The banking sector operates under the Banking Ordinance and Subsidiary Legislation, consolidated to May 1998, and the Banking (Special Provisions) Ordinance and Subsidiary Legislation, consolidated to May 1998, as well as other applicable laws and regulations. The legislation provides for two types of licensed banks. One operates under a “national banking license,” which permits banks to conduct business in and from TCI, with TCI citizens and with those who are ordinarily or temporarily resident. The second is an “overseas banking license,” which enables banks to conduct business from within TCI, but not with TCI residents. Conditions may be and are attached to banking licenses. Banks may hold one or both types of license, provided that segregated accounting or a separate entity is utilized.

38. As noted above, the KPMG report issued in October 2000 recommended establishing operational independence for the FSC, strengthening FSC operational practices with respect to prudential supervision, liberalization of supervisors’ access to client information, and systematic monitoring and enforcement of licensed firms’ compliance with their obligations under the Anti-Money Laundering Regulations. Section III above discusses progress to date in implementing these recommendations.

Supervisory authority

39. Within the FSC, the banking superintendent has statutory responsibility for administering the bank ordinance. As noted above, the incumbent banking superintendent is also the managing director of FSC. Her direct support staff for both functions includes one administrative assistant and one clerical assistant. Recruitment of additional staff to support banking supervision has been frustrated by budgetary and salary limitations. Although the banking supervisor has operational responsibility for the supervision of banks, executive responsibility for all significant licensing, supervisory, and enforcement actions rest with the FSC's licensing committee.

40. Although no specific legal enforcement powers have been given to the FSC for ensuring effective implementation of the Anti-Money Laundering Regulations, the banking supervisor exercises responsibility of AML compliance by banks as part of her overall responsibility for ensuring that banks are in compliance with all applicable legal obligations.

Main findings

41. The assessments identified two issues that could impair the operational independence of the FSC:

Supervisory independence

42. **The establishment of the FSC as a statutory body has not achieved the operational independence recommended by the KPMG Report and called for by international standards.**

43. Private practitioners active in the financial industry constitute a majority of both the board of directors and the licensing committee, posing the risk of regulatory captures. This issue is particularly concerning with respect to the licensing committee, which plays a central role in licensing and supervision decisions. This governance structure, combined with FSC staffing weaknesses, unduly diminishes the authority of the managing director and the FSC's professional staff. Recusals by board and committee directors are common, reflecting the frequency with which these bodies take up issues touching on directors' interests. Even where no conflict of interest exists, privileged access by private board and committee members to competitive information is a concern for a small financial community like that in TCI.

44. While it is appropriate that the board of directors of FSC be ultimately accountable to the government or the governor, it is disconcerting that the governor retains authority to give instructions to the FSC on key operational matters. More troublesome is the active influence over FSC operations that is exercised by the government via budgetary restrictions, including ad hoc authorization for funding of special investigations beyond limits contemplated in the budget.

Implementation of financial supervision

45. **Recent legislation has substantially enhanced the TCI legal framework for financial supervision. Implementation of that legal framework, however, is poor.**

46. As noted, the governance structure of FSC lodges executive decision making in a non-executive licensing committee, a majority of whom are active practitioners in the TCI financial industry. This structure provides little autonomy for the managing director and professional staff of FSC, and inhibits supervisory initiative. Financial ordinances give FSC only weak enforcement powers with sanctions largely limited either to revoking licenses or to pressing criminal charges. Direct political interference in FSC operations does not appear to be a problem, but inadequate and unreliable funding have undercut the FSC's ability to recruit and retain staff, and to initiate supervisory initiatives not anticipated in the barebones budget until-now authorized.

47. The FSC staff devoted to ongoing supervision, as distinct from routine licensing and registration, is inadequate. Many basic supervisory functions are being neglected or left incomplete because of staff turnover or lack of staff. Implementing regulations and supervisory guidance have yet to be developed for much of the new financial legislation. No systematic monitoring of the TCI financial sector for compliance with AML/CFT requirements is being carried out and, more generally, regulatory compliance is inadequately checked. Prudential regulation of banks requires more time and attention than the banking supervisor can provide, given her dual responsibility for administration of FSC.

48. The mission is concerned that unless these two issues are adequately addressed, the progress made to date will not be sustained, nor will the FSC be able to address its mandate in an effective manner. This concern has to be viewed against the general background of a number of weaknesses in the banking sector.

Basel Core Principles for effective banking supervision

49. TCI has to be commended for the intense revisiting of prudential regulations and powers during the last two years following the recommendation of the KPMG report. However, the detailed assessment results demonstrate that the prudential regulations and their implementation are still to be improved on several points. The two issues that dominate have been mentioned above. The first relates to the supervisory independence and the second to the fact that implementation of the recently revisited legal framework is poor.

Objectives, autonomy, powers, and resources (CP 1)

50. While many of the key elements of an effective legal framework for banking supervision are in place, weakness are evident in a few areas. The lack of independence of the FSC represents a major concern (CP 1(2)). The licensing procedure (CP 1(3)) is not matching the legal provisions, the legal framework has to be harmonized (CP 1(4)), and the right of the governor to issue guidelines to the supervisor could potentially impair its independence.

Licensing and structure (CPs 2–5)

51. Most of the criteria for the licensing, ownership and structuring of banks are well satisfied. However, weaknesses in consolidated supervision detract from compliance with CP 5.

Prudential regulations and requirements (CPs 6–15)

52. Prudential regulations and requirements do not compare favorably with international standards and “best practices.” Although some of the criteria are well satisfied, in other areas policies require further development. Serious weaknesses were noted in the credit policies, the loan evaluation and provisioning, large exposures limits, connected lending, other risks, internal control, and AML.

Methods of ongoing supervision (CPs 16–20)

53. The FSC has a substantial resource deficit and the mission is concerned that banking supervision is not able to fulfill its mandate for ongoing supervision. On-site supervision represents a major weakness. Another supervisory gap concerns AML. TCI’s general reputation as a well-regulated jurisdiction and the economic interests that are derived from that may therefore be at stake.

Information requirement (CP 21)

54. The assessment confirmed the FSC’s compliance with this CP.

Formal powers of supervisors (CP 22)

55. While the authority of the supervisor is generally adequate, the range of remedial actions available is limited. On the occasion of a future revision of the BO and the FSCO, the authorities may wish to consider giving the FSC a number of additional powers.

Cross-border banking (CPs 23–25)

56. While various improvements in operational practices would be desirable, the criteria for these CPs are generally satisfied.

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

Reference Principle	Recommended Action
Independence (CP 1(2))	<p>Currently active private practitioners be limited to a minority of the positions on the board of directors and excluded from the licensing committee.</p> <p>Consideration be given to inviting experienced nonresidents to join the board and serve on the licensing committee, a practice that is followed in the U.K. and the Crown Dependencies.</p> <p>Alternatively, consideration should be given to abolishing the licensing committee and replacing it with a strong executive committee under the managing director and reporting to the board for policy and budgetary matters.</p> <p>The provisions of the FSC ordinance regarding funding of FSC through fees paid by the financial sector be implemented based on a formal arrangement between the government and the FSC that insures that FSC receives a share of the fees paid by the financial sector adequate to fund supervisory practices that meet international standards.</p> <p>The case for additional resources should benefit from an in-depth analysis of the supervisory objectives and the means needed to fulfill those objectives.</p> <p>A review of the business process of prudential supervision should be organized in order to enhance its efficiency and an appropriate change process should be agreed upon in the very near future.</p>
Legal Framework CP 1(3)	It should be envisaged to give the FSC powers to set prudential standards administratively.
Investment Criteria CP 5	The LC needs a court order to have access to the name of any settlor or to the name of any trust or to any publication relating to a trust. The effectiveness of FSC's consolidated supervision may therefore be seriously hampered. Compliance with CP 5 necessitates the BO or the TLO to be amended.

Reference Principle	Recommended Action
Credit Policies CP 7	<p>The FSC has to develop a comprehensive on-site credit risk program. Additional experienced resources are therefore to be put in place in order to allow the FSC to fulfill this objective without further delay.</p> <p>Synergies with the external auditors can also be developed in order to close this prudential gap as soon as possible.</p> <p>To add to this program, the FSC may want to consider reinforcing the need for the application of international credit risk “best practices” by providing a copy of the Basel Committee guidance on this subject to all banks.</p> <p>The Turks and Caicos Regulation has to be completed by introducing a requirement that decisions on connected lending should be made on an at arm’s length basis.</p>
Connected Lending CP 10	<p>Introducing the requirement to extend loans to connected parties at market conditions should amend the banking regulation.</p> <p>Simultaneously, the LC should be given the discretionary power to deduct on a case-by-case basis such loans from capital when assessing capital adequacy or to require collateralization.</p> <p>The external auditors should be mandated to inform the shareholders and include in their annual statements a report on connected lending.</p>
Other Risks CP 13	<p>The scope and frequency of the on-site examination process has to be enhanced and additional resources (middle management staff) are therefore to be provided for.</p>
Internal Control and Audit CP 14	<ul style="list-style-type: none"> • The LC should highlight the pivotal importance of the internal control function by circulating the reference document, “Framework for internal control systems in banking organizations,” September 1998. • The external auditors could be associated with this initiative and asked to report on the application of the principles contained in the document by the individual banks.

Reference Principle	Recommended Action
Money Laundering CP 15	<p>The FSC should be provided with the authority, the mandate, and the resources to develop an adequate on-site and off-site supervision program, which ensures compliance with any AML law and regulations applicable to financial institutions under its supervision.</p> <p>The LC should be able to appoint without further delay an experienced compliance officer in order to set in train periodical checks of the banks' money laundering controls and their systems for preventing, identifying and reporting fraud.</p> <p>However, given the backlog that has occurred in this sensitive domain, the LC may want to consider the appointment of one or more experts.</p> <p>The existing guidance notes should be revisited and expanded. This exercise could profit from the Crown Dependencies joint consultation paper entitled: "Overriding Principles for a Revised Know Your Customer Framework."</p>
On-site and Off-site Supervision CP 16	<p>The LC should prioritize the completion of the on-site supervision methodology and ensure that the methodology in place is reassessed to ensure that it provides for a consistent approach and clearly defined deliverables for bank examiners and external auditors.</p>
Validation of Supervisory Information CP 19	<p>The establishment of a coherent process for planning and executing on-site visits.</p> <p>The requirement that key supervisory returns are examined at least annually by the auditors and a report submitted to the LC.</p> <p>Annual trilateral meetings between the LC, the external auditors and the licensed bank.</p> <p>Additional efforts to increase the synergy between the LC and the external auditors. The transmission of a copy of their annual management letter to the LC should be made mandatory.</p>

Authorities' response: Assessment of Compliance with the Basel Core Principles

Core Principle 1 (2)—Independence and adequate resources

Please note our comments above regarding independence of the Financial Services Commission.

Core Principle 1 (3)—Legal Framework

We concur with your recommendations that the Financial Services Commission should have powers to set prudential standards administratively and in this regard we propose to take the following action:

- introduce legislative provisions for the FSC to have power to set prudential standards administratively to regulate licenced financial institutions to internationally accepted standards.

Core Principle 5—Investment Criteria

We concur that consolidated supervision of the operations of a bank is hindered by the lack of legislative authority to request the name of any settlor or the name of any trust or any publication relating to any trust that has connection with a financial institution without a court order.

We confirm that we have already taken steps to remedy this supervisory deficiency and the proposed legislation has recently had its first reading in the Legislative Council to give power to the FSC to have access to client information of all licensed entities.

Core Principles 7—Credit Policies

We concur that inadequate staffing has hampered the FSC's ability to develop and implement a comprehensive on-site credit risk programme. We have recognised the value of a close working relationship with external auditors to bridge the gap and in this regard we do meet with the auditors occasionally to get some feedback on the industry. However, we propose to formalise the procedure and take the following action:

- to introduce as part of the prudential standards provisions to give the FSC authority to meet with the auditors annually to review financial institutions financial returns and also to require that they provide the FSC with a copy of the auditor's management letter to each regulated institution.
- to amend the Banking Regulations to require institutions to make lending decisions to counterparties connected to the institution at arm's length basis.

Please note the FSC recently recruited a bank/trust examiner to enable the authority to carry out comprehensive on-site inspection of all licensed institutions and to implement a programme to visit each institution biennially.

With regard your concern that we reinforce the need for application of international credit risk best practices, we confirm we have issued a copy of the Basel Committee publication on Principles for the Management of Credit Risk to all bank financial institutions licensed in the Islands.

Core Principles 10—Connected lending

We note your recommendations and concur that the authorities should introduce the requirement to extend loans at market conditions to counterparties connected to the lending institution, and give discretionary power to the FSC to deduct on a case by case basis such loans from capital when assessing capital adequacy or to require adequate collateralization. We propose to adopt the following approach:

- to amend the Banking Ordinance to introduce the requirement that loans to counterparties connected to lending institutions should be extended at market conditions as exists in the Islands.;
- to amend the Banking Ordinance to given discretionary powers to the Licensing Committee to adjust capital adequacy of licensed institution where loans are extended to counterparties connected to the lending institution;
- to introduce legislation requiring auditors to include in their annual audited accounts a statement giving details of credit facilities extended to counterparties connected to the lending institution.

Core Principle 13—Other Risks

We agree with the recommendation that we should enhance the scope and frequency of on-site examination and in this regard, please note the action taken with regard the recruitment of suitably qualified staff.

Core Principle 14—Internal Control and Audit

Please note that we issued the publication on internal control function “Framework for Internal Control Systems in Banking Organisations” to all bank financial institutions and auditors approved by the Permanent Secretary, Finance in July 2001.

Core Principle 15—Money Laundering

We note the IMF recommendations with regard the acquisition of adequate resources in the FSC to develop on-site and off-site supervisory programme and the appointment of an experienced compliance officer to establish a plan to carry periodical checks and put in place

systems to monitor banks' anti-money laundering controls and their procedures for preventing, identifying and reporting fraud. As mentioned earlier the FSC has projected in its budget for the financial year 2003-2004 allocation of adequate resources to meet these needs.

The IMF recommendation that the FSC should revisit the existing anti-money laundering guidance notes had already been taken on board. However, the FSC had put the project on hold as the FATF has been revising their 40 FATF Recommendations for combating money laundering. The publication of the revised FATF 40 Recommendations was issued in July 2003 and the FSC proposes to complete a review of the guidance once the authorities have agreed any IMF recommendations for legislative changes against the revised standards.

Core Principle 16—On-site and off-site Supervision

We note your recommendations that the Licensing Committee should prioritize the completion of the on-site supervision methodology and in this regard the FSC has contacted CARTAC the regional funding agency who has prepared a bank supervisory manual which contains on-site supervision methodology. The FSC has also contacted Caribbean Anti Money Laundering Programme (CALP) for assistance in the training of the compliance officer and bank/ examiner to carry out on-site inspection of financial institutions and to check their compliance with the requirements of Turks and Caicos Islands anti-money laundering legislation and policies and procedures they have implemented to combat money laundering and financing of terrorism. CALP is schedule to carry out training in TCI during January 2004.

Core Principle 19—Validation of Supervisory Information

We note your recommendations that the authorities should establish a coherent process for planning and executing on-site visits; the requirement that key supervisory returns are examined annually by external auditors and that annual trilateral meetings be held between the Licensing Committee, the external auditors and licensed banks, and that we mandate for a copy of their management letter to the licensed banks be submitted to the Licensing Committee.

We concur with the recommendations and have already indicated above the steps we propose to take.

B. IAIS Insurance Core Principles

General

57. This IAIS Insurance Core Principles assessment has been prepared by Mr. Azeem Motani, Manager, Financial Institutions, Office of the Superintendent of Financial Institutions, Canada, as a part of the IMF Offshore Financial Center Assessment of the Turks and Caicos Islands. The assessment followed the IAIS Core Principles Methodology. The assessment made use of a self-assessment prepared by the SOI in the FSC and included a review of the IO, regulations, guidelines, extracts from licensing files,

monitoring files, and other supervisory documents. Discussions were held with the staff of FSC and with representatives of the TCI insurance industry. Contact was also made with North American and British Virgin Islands insurance supervisors as well as a Canadian direct writer.

58. The members of the FSC provided extensive and valuable cooperation in facilitating the mission by preparing the self-assessment against the IAIS Core Principles, being available for extensive meetings, and arranging industry meetings.

Institutional and macroprudential setting—overview

59. The TCI insurance industry was established in 1989. It has since become one of the world's largest credit life reinsurance jurisdictions. TCI is the most important center for the PORCs (Box 1).

Box 1. Producer-Owned Reinsurance Companies (PORCs)

Producer-owned reinsurance companies (PORCs) provide reinsurance for credit life insurance, product warranty insurance, and mortgage insurance. They are typically owned by United States retailers who offer the insurance as an adjunct to their primary business. The insurance is underwritten by a U.S. direct writer, who, in turn, reinsures all or most of the risk with the TCI reinsurance company owned by the “producer.” The underlying insurance tends to be short-term, low risk, and highly profitable. Credit life is typically sold in conjunction with automobile sales or home purchases. Product warranty insurance is offered on a wide range of retail products and has well-defined risk characteristics, and tends to be highly profitable.

The PORC structure allows the producer to share in the earnings generated by the insurance associated with his sales. The producer (a retailer or bank) encourages the customer to buy credit life or product warranty insurance from an unrelated U.S. insurer (direct writer) selected by the producer, acting as an agent for the direct writer. Rather than receiving a taxable commission however, the producer enters into a reinsurance arrangement with the direct writer. The direct writer agrees to cede all or a large part of the risk to a reinsurance company owned by the producer, the PORC, with the reinsurance effectively compensating the producer for his role in originating the business. U.S. tax law provides an additional incentive for small- and medium-sized producers to use this reinsurance structure. According to industry participants, net insurance premium income up to \$1.5 million is taxed at a preferential low rate. Reportedly, because the U.S. tax rate is low, U.S.-owned PORCs typically elect to be taxed as U.S. residents, even though TCI is a zero tax jurisdiction. Absent a tax advantage, the attraction of using a TCI reinsurance firm rather than U.S. reinsurance firm is said to be the low cost of incorporation and licensing, low capital, and a minimum of regulatory requirements in the TCI compared to any of the states in the U.S.

Since the PORCs are small and unrated reinsurance companies, the U.S. direct writer requires assets to be pledged as security against the risk of nonperformance by the PORC. Typically, the direct writer requires a custodial account consisting of assets approved by the direct writer in an amount that is at least equal to or greater than the liabilities assumed. This allows the direct writer to reduce its technical provisions (take reinsurance credit) on its balance sheet. The burden lies with the direct writer (ceding entity) to make sure that a PORC’s capitalization is maintained and the reserve security is adequate. Failure to do so would result in loss of reinsurance credit. The direct writer reports annually to the U.S. regulator the amount of liabilities ceded to the PORC and the amount of the reserve security. These annual reports are audited by the U.S. regulator. The direct writer who provides the insurance coverage, in many cases, also acts as a U.S.-based “insurance manager” and in addition to accepting premiums, pays claims and carries out various other administrative tasks such as preparing financial statements and tax returns.

60. PORCs constitute the bulk of the TCI insurance industry, representing 2,857 out of 3,013 licensed insurers. Intensified scrutiny by U.S. Internal Revenue in 2002 led to a slight slowdown of licensing of PORCs. However, licensing continues at the rate of about 200 per annum. Captive insurance companies account for a small share of the insurers licensed in TCI. As of December 31, 2002, there were 143 U.S.-owned captives.

61. The domestic market is primarily served by foreign-owned insurance establishments, primarily foreign branches, and subsidiaries of regional insurance companies writing domestic business exclusively with TCI residents. At last count, there were 8 domestic

general insurance companies doing exclusively domestic business. There are 5 domestic subsidiaries or branches of foreign life insurers providing long-term insurance.

62. There are 6 brokers/agents and 6 licensed insurance managers in TCI. There is a perception that there may be conflicts of interest as brokers also hold agency licenses; there is price fixing in the auto and property domestic insurance market (to provide stability); external audit firms provide licensing services to insurance companies and act as auditors for insurers of companies they did not help to license. One auditing firm also holds an insurance manager's license (through a separate arm).

63. The PORC sector of the TCI insurance industry is considered to be relatively low risk. Other lines of business in TCI cover fairly conventional insurance risks. TCI implicitly follows a risk-based approach to insurance supervision and, on this basis, it is the 13 domestic insurers who would pose the greatest risk to the FSC and warrant greater supervisory efforts. Captives do not insure domestic risk (they are set up exclusively to insure the risk of a foreign parent). Although market conduct issues do not normally arise in the case of captives, these companies are still subject to regulatory and supervisory requirements to ensure that they comply with the limits of their license and do not pose a money-laundering risk.

64. The FSC has taken the position that PORCs pose minimal risk to TCI and can be exempted from normal supervisory and prudential requirements. Key considerations are that PORCs are a legitimate corporate structure under U.S. law; they do not do business in the TCI; they do not have a physical presence in the TCI; they do not have TCI bank accounts; the U.S. direct writer is strongly collateralized; loss experience is minimal; and direct writers are supervised by the U.S. regulators.

65. Based on this risk assessment PORCs have enjoyed exemptions from requirements

- to file audited or actuarial statements;
- for annual financial reports;⁵
- to have a local insurance manager;
- to meet the capital requirements for other reinsurers;
- to file a solvency statement to be certified annually by an independent auditor;
- to place a deposit with the FSC or have that liquid assets or a bank account in TCI;
- to pay annual license fees for credit life PORC.⁶

⁵ To date, PORCs have only been required to file an annual compliance certificate but, in response to the KPMG report, the FSC has introduced the requirement to file annual financial statements and is in the process of introducing an annual fee of \$100.

⁶ See footnote 1.

66. Due to confidentiality restrictions, we were unable to get data on individual companies and there is no industry analysis done by the FSC. Financial reporting is not required and, hence, no reliable figures relating to total gross premiums, assets or capitalization are available. However, the sector is understood to be profitable to the insurer and practitioners alike. Until now, financial information has not been requested from PORCs. However, based on 2002 amendments to the IO, PORCs will be required to file annual financial statements effective by year-end 2003.

67. Insurance supervision in TCI focuses primarily on licensing new insurance companies and administering filings by existing licensees. Staff resources do not permit on- and off-site supervision although, the need for such programs is recognized.

68. There are no specific standards for the valuation of liabilities (including technical provisions), although the SOI requires an actuarial report for life insurers once every three years but not for general insurers. There are no actuaries in TCI. The IO recognizes Canadian-, U.K.-, and U.S.-qualified actuaries.

69. The legal system is based on British Common Law, and there is a need to address inconsistencies, consolidate, and amend existing IOs. There is inadequate transparency in the regulatory system, as the FSC has no public web site, it does not yet produce an annual report and, in the opinion of the industry, there has been inadequate consultation when revising legislation or guidelines.

General preconditions for effective insurance supervision

70. The legal profession seems to be adequate and the judicial system appears to work adequately for the insurance companies. Very few insurance claims end up in court. The legal framework could usefully be updated to address various gaps identified by the general insurance industry, such as, the absence of a statute of limitations for accident claims. There is no insurance protection/guaranty fund in view of the small size of the market.

71. The IO and the FSC Ordinance provide a suitable framework covering licensing, supervision, sanctions, and legal protection for supervisors. The IO provides for various conditions that would lead to a suspension or revocation of a license and sanctions against insurance licensees, the company, the directors, officers, and auditors. The SOI also requires additional enforcement powers that introduce intermediate measures (“surgical tools”) to add to the current arsenal of “axes” that essentially revoke licenses for failure to comply with sanctions.

72. Local auditors are primarily U.S. and U.K. qualified and are required by the IO to apply “generally accepted” accounting principles, which tend to be international accounting standards issued by the International Accounting Standards Committee (IASC). Auditors look to Canada, U.K., and the U.S. for guidance on insurance accounting standards as the IASC board is currently working on this.

73. A weakness in the insurance supervisory regime is the lack of standards for the valuation of liabilities, including technical provisions. Consideration should be given to outlining acceptable actuarial standards.

74. FSC has the authority, but not the ability (based on current resources and absence of methodology), to meet most of the IAIS Core Principles for insurance. The principles regarding licensing, change of ownership, capital adequacy, sanctions, cross-border cooperation, and confidentiality appear to be the strongest aspects of FSC's supervisory regime.

Main findings: summary

75. The 2001 legislative amendments establishing the FSC as an independent and single regulatory and supervisory body, together with the 2002 amendments to the IO, have addressed several of the concerns raised in the KPMG report. The measures provide an excellent platform for further refining the independence, structure, and powers of the FSC.

76. The IO and the FSC Ordinance identify supervisory objectives, supervisory authority, and enforcement powers of the SOI and FSC. However, there is a need for more operational independence and greater clarity in certain areas, such as, the overlaps in respective roles of the FSC board, the licensing committee, and the SOI. The SOI has the authority but not the ability (based on current resources and absence of methodology) to meet most of the IAIS Core Principles for Insurance. The principles regarding licensing, changes in control, and confidentiality are, relatively, the most compliant aspects of the FSC's supervisory regime.

Organization of an insurance supervisor (CP 1)

77. The insurance supervisor is not operationally independent from either political authorities or the insurance companies that it supervises in the execution of its supervisory tasks (see Section II above). The insurance supervisor needs to adopt more clear, transparent, and consistent regulatory and supervisory processes, since the IO and the guidelines give the SOI significant discretion in implementing the legislation, especially for PORCs. The criteria for setting differing requirements and granting exemptions, although appropriate in the case of PORCs, are not documented or circulated to the industry.

Licensing and changes in control (CP 2-3)

78. Business plans do not require projected capital or solvency margins; capital requirements for PORCs are significantly reduced, but no written policy in this regard was available. There is inadequate transparency in the licensing process, as the SOI is not required to specifically consider or outline the types of reason for denying a license on the basis of facts from which it could be deduced that the person concerned will not manage the insurance company in a proper fashion and the documents of formation do not require information on actuaries to be provided (the actuary's role is not given sufficient prominence).

Corporate governance and internal controls (CP 4–5)

79. The FSC has not issued any standards on corporate governance. The IO does not directly require the board of directors to address any of the requirements of CP 4, and these requirements are not covered in the Companies Act either. The FSC has not issued adequate guidance on internal controls. The IO provides the SOI with wide-ranging general powers, however, there is no direct requirement for the board of directors to address internal control issues. Although the auditors are required to advise the SOI of breaches in observing internal controls, the SOI does not require or receive a copy of the management letter to the insurer.

Prudential rules CP 6–10

80. The IO provides wide-ranging general powers, but the SOI does not require insurers to have in place an overall strategic investment policy, formulated and approved by the board of directors, which addresses the control requirements of the Principle. The Business Plan should be expanded to require the filing of an investment policy that addresses the above. The SOI relies heavily on the business plan, the annual compliance reports from the insurer, confirming adherence to or changes made to the business plan, and the identification of noncompliance by the auditor who is then required to report breaches to the SOI.

81. The SOI does not prescribe professional standards for actuarial valuations. Actuarial valuations are not required for general insurers, and only every three years for life insurers. The SOI does not have procedures in place to verify the adequacy of the technical provisions or adequate skilled resources, other than himself, to make an assessment of the adequacy of the technical provisions.

82. The failure to require actuarial reports for all insurers (exemption for PORCs is acceptable) is a significant weakness in the supervisory process. Until the FSC amends the legislation to require annual actuarial valuations and develops adequate resources to undertake a review of the technical provisions reserves, the external auditors should be required to provide an annual letter from their consulting actuary attesting to the adequacy of the technical provisions of their regulated TCI clients.

83. The IO's capital adequacy requirements appropriately reflect the size, complexity, and business risks of the insurers in TCI. However, although the requirements regarding the capital to be maintained by companies, which are licensed or seeking a license, are clearly defined and minimum levels of capital required are published in the licensing guideline, the SOI has significant discretion with respect to the actual capital requirement. In the case of PORCs, this requirement is \$5,000, but there is no written policy in this regard. There is a need for more transparency in the process.

84. The insurance supervisor has the authority to oversee reinsurance arrangements. Insurance companies are required to evaluate credit exposures to reinsurance companies, but no specific requirements have been established with respect to such credit risk.

Market conduct (CP 11)

85. The IO does not specifically address the requirements of this principle. The SOI expects that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers. The licensing legislation allows brokers to act also as agents, which could create an opportunity for conflict of interest, but there is no disclosure requirement. Policy-holder protection and market-conduct practices should be given more attention since price competition among the small number of domestic insurers appears limited.

Monitoring inspection and sanction (CP 12–14)

86. It is understood that insurers have a history of late filings and the recently introduced penalties are not being implemented. In addition, certain PORC returns are not being signed by the appropriate level of senior management responsible for the accuracy of these returns. The insurance supervisor does not have an ongoing documented framework for the monitoring of the condition and performance of the companies.

87. The SOI does not have a program for conducting on-site examinations, although the IO gives the SOI the necessary powers to do so. The insurance supervisor does not have the authority to extend on-site inspections to third parties such as companies providing outsourcing services (e.g., data processing) to the insurer.

88. The SOI has several significant powers to impose sanctions under the legislation. However, the range of remedies available needs to be broadened, whereby, the SOI can tailor the sanctions based on the severity of the situation.

Cross-border operations, coordination, and cooperation and confidentiality (CP 15–17)

89. The IO addresses a significant number of the cross-border criteria. However, the process for the SOI to refuse a license for a foreign establishment in TCI, or to impose additional conditions on a license, is not transparent.

90. The FSC has adopted and adequately addressed the confidentiality requirement, but it needs to address the issue of sharing information with law-enforcement agencies. The IO does not allow the SOI to disclose information relating to exchange-control regulations and income-tax-collection purposes.

Table 2. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action
<p>Organization of an Insurance Supervisor CP1</p>	<p>Amend the FSC Ordinance to bar industry representatives from membership in the Licensing Committee so as eliminate potential conflicts of interest and leakage or abuse of confidential supervisory and client information.</p> <p>Eliminate the requirement for the SOI to obtain Licensing Committee authorization for funding any investigations or examinations.</p> <p>Provide adequate funding to address the need to hire at a reasonable salary, adequate, qualified staff to conduct on- and off site examinations.</p> <p>The FSC should publish an annual report as required in the Ordinance and preferably post it on a FSC website together with all guidelines and procedures.</p> <p>Develop internal procedures explaining the criteria for granting exemptions from, or deviating from, established requirements.</p> <p>Adopt more clear, transparent, and consistent regulatory and supervisory processes, since the IO and the Guidelines give the SOI significant discretion in implementing the legislation.</p> <p>Enhance transparency of the supervisory process by encouraging the AG to make drafts of legislation and guidelines available for public consultation before they are issued.</p>
<p>Licensing and Changes in Control CPs 2–3</p>	<p>The reasons for which a license application can be declined, for example, a previous conviction for dishonesty—tax evasion, should be set out in law or regulations.</p> <p>The business plan should explicitly require information on capital or solvency margins.</p> <p>A directive should be issued to address outsourcing and require the insurers’ third-party service providers to give an undertaking allowing the SOI access to their premises and records.</p> <p>The documents of formation should require information on actuaries to be provided.</p>

Reference Principle	Recommended Action
Corporate Governance and Internal Controls CPs 4–5	<p>The FSC should issue standards on corporate governance and internal controls based on the IAIS requirements tailored to the domestic insurance industry.</p> <p>The insurer should be required to provide the SOI with a copy of the management letter from the external auditor.</p>
Prudential Rules CPs 6–10	<p>The SOI should require the business plan to include the investment policy, as approved by the board of directors, that addresses the requirements of Principle 6.</p> <p>The SOI needs to develop an examination program to check that insurers have in place adequate internal controls to ensure that assets are managed in accordance with the overall investment policy and the legal and regulatory requirements or require the auditors to cover those requirement as part of the auditors report on internal controls.</p> <p>The SOI should develop supervisory procedures and obtain sufficient resources and capacity to meet the requirements of CP6–EC5, EC 7, AC 1, and AC2.</p> <p>The SOI should consider requiring the external auditor (as part of the audit) to provide an annual letter from its consulting actuary attesting to the adequacy of the technical provisions, or else require annual actuarial returns for both general and life insurers. For PORCs, such a letter should be requested from the actuary of the direct writer.</p> <p>The process for setting reduced capital requirements should be transparent. The Guideline on Issue of Licenses should be expanded to address the actual capital requirements for PORCs and the related rationale.</p> <p>THE SOI should ensure companies review capital adequacy internally on a quarterly basis, even if reporting to FSC is only on an annual basis.</p> <p>The SOI should monitor where the reinsurance is placed and the credit rating of the reinsurer.</p>
Market Conduct CP 11	<p>The Insurance supervisors should consider issuing directives requiring insurers and intermediaries to exercise the necessary knowledge, skills, and integrity in dealing with their customers. The licensing legislation allows brokers to also act as agents, thereby, creating an opportunity for conflict of interest. Brokers should be required to disclose this conflict to the customer.</p>

Reference Principle	Recommended Action
<p>Monitoring, Inspection, and Sanctions CPs 12–14</p>	<p>The SOI should develop a program of regular on-site examinations, develop appropriate risk based on-site examination procedures for each type of company operating in TCI and obtain the resources necessary to carry out regular on-site examinations.</p> <p>The SOI needs to have the authority to extend on-site inspections to third parties, such as, companies that provide outsourcing services (e.g., data processing) to the insurer. The inability to do so could impede their ability to review the overall internal controls framework. (Also see CP2–3.)</p> <p>The SOI should perform market conduct examinations for purposes of determining the treatment of customers.</p> <p>Revise the IO to allow SOI specific authority:</p> <ul style="list-style-type: none"> • to hire a third party at insurers expense and include a provision to charge the company for any third party work or investigation; • to require insurers to hire, using their own resources, independent auditors or actuaries for auditing or reviewing all or specific items of the financial statements whenever the insurance supervisor has doubts as to their accuracy. <p>Develop an on-going documented framework for the monitoring the financial condition and performance of the companies.</p> <p>Timely filing of audited financial statements and other returns should be enforced, including through the introduction of fines or other penalties for late or inaccurate filing.</p> <p>Implement the requirement for PORCs to file annual financial statements effective YE 2003.</p> <p>The range of remedies available need to be broadened, whereby, to the SOI can tailor the sanctions based on severity of the situation.</p> <p>Develop written procedures to address the process for implementing and following up on remedial actions. All significant remedial actions should be issued in writing and require written responses and progress reports.</p>

Reference Principle	Recommended Action
Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality CPs 15–17	<p>The process for the SOI to refuse a license for a foreign establishment in TCI, or impose additional conditions on a license should be more transparent.</p> <p>Document administrative actions taken to support cross-border cooperation.</p> <p>Clarify regulations and procedures for sharing of information with law enforcement agencies.</p>

Authorities response: Assessment of Observance of the IAIS Insurance Core Principles

Core Principle 1—Organisation of Insurance Supervisor

- *Recommendation that industry representatives should be prohibited from membership of the Licensing Committee:*

Please see comments under Basel Core Principles on the Independence of the FSC.

- *Recommendation regarding adequate staffing:*

The FSC is currently recruiting for a suitably qualified Deputy Superintendent of Insurance.

- *Eliminate the requirement for the SOI to obtain Licensing Committee authorising for funding any investigations:*

We do not agree with your recommendation that the Superintendent of Insurance should not be required to obtain Licensing Committee authorisation for funding any investigations or examinations. If your recommendation refers to routine inspection of licensed insurance entities the Superintendent of Insurance can, under the provisions of section 3 of the Insurance Ordinance carry out inspection under his own motion and or with the authority of the Licensing Committee. Here, no prior authority is required from the directors of the Board of FSC since the expenditure is part of the Superintendent’s supervisory function for which budget approval has been obtained. If, however, special investigations are required to be carried out then it is necessary for the Superintendent to obtain authority from the Board as no budget allocation would have been projected for such expenditure.

- *Develop internal procedure explaining the criteria for granting exemptions or deviating from established requirements.*

- *Adopt more clear, transparent and consistent regulatory and supervisory processes, establish guidelines for public consultation prior of draft legislation.*

The FSC sought technical assistance from CARTAC (the regional resource agency whose project is 50% funded by CIDA with contributions from IDB, Ireland, IMF, UK, UNDP and the US) to prepare procedure manual for the FSC. CARTAC has now completed a draft of the Bank's Manual and on completion of this draft will proceed to prepare a draft manual for the Insurance Sector when the subject matters recommended will be addressed as part of the exercise.

Core Principles 2 and 3—Licensing and Changes in Control

Recommendation concerning the issue of procedure manuals and procedure guides:

- Please see above comments on the issue of procedure manuals and guidelines.

Recommendation that the business plan should require information on capital or solvency margins:

- The Superintendent of Insurance has consulted with the industry and a revised business plan has been circulated and will be implemented in January 2004.

Core Principles 4 and 5—Corporate Governance and Internal Controls

The Board of Directors of the FSC concur with the recommendation that a corporate governance document should be prepared for the industry. However, it is the intention for the document to cover all areas of the functions of the FSC.

Core Principle 6—Prudential Rules

We concur with the recommendations pertaining to development of prudential rules for the Insurance Department with regard to:

- A statement on investment policy in the business plans submitted by applicants for insurance licences as approved by the board of directors. Legislative approval will be sought to make this requirement mandatory.
- Guidelines be introduced to require that checks should be carried out into insurers to ensure that they have adequate internal controls and risk management tools.
- All insurers should submit a copy of the Management Letter from their external auditor and for auditors to be required to include in their report a statement on the insurers' internal controls. In this regard, legislative approval will be sought to make these requirement mandatory.
- We confirm we will implement the recommendations concerning the prudential guidelines in respect of IAIS Core Principle 6–10

Core Principle 7—Liabilities

We note your comments on the actuarial requirements under this core principle. We are however mindful that the specialist captive insurance companies that are licensed in the TCI do have unique features and for this reason we will carry out a study to ensure that any actions we take in response to your recommendations and our own concerns are appropriately addressed. It is the intention that the department meet the international requirements for the type of business that is conducted in the Islands.

Core Principle 8—Capital Adequacy and Solvency

We concur with your recommendations that there needs to be more transparency in the process of setting lower capital requirements. The Superintendent of Insurance is to prepare a paper for the Licensing Committee on the subject following review of the industry norm with the view that the Licensing Committee recommends to the directors of the Board of the FSC for the adoption of a policy for capital adequacy requirements and solvency margins.

Following a policy decision by the Board approval will be sought to bring into legislation revised provisions for capital adequacy requirements and solvency margins for companies licensed under the Insurance Ordinance.

Core Principle 11— Market Conduct

We concur with the recommendation that the Superintendent should issue directives to insurers and intermediaries requiring that they exercise the necessary knowledge, skills and integrity in their dealings with customers. It is the intention that FSC produce a Code of Conduct for the financial services industry which would include the entities licensed under the Insurance Ordinance.

Core Principles 12–14—Financial Reporting

We note the importance of the Superintendent developing a programme for on-site inspection and appropriate procedures and your recommendation that this be implemented for each type of company operating in the TCI. We had commenced the development of plans before the assessment and it is intended that once preliminary work has been done, that the project will be carried out by CARTAC.

Concerning the recommendations that the Superintendent be given authority to extend on-site inspections to third parties and conduct market examinations for purposes of determining the treatment of customers, these are legislative issues and approval will be sought to implement these criteria.

Legislative approval will also be sought for introducing a graduating scale of remedies and sanctions for breaches of prudential requirements in the legislation to be administratively imposed by the Licensing Committee.

- *The SOI needs to develop an on-going documented framework for monitoring the financial condition and performance of the companies. The SOI also needs to set up an adequate information system to analyse financial returns and monitor trends and track timeliness and completeness of returns received from insurers.*

The Insurance Department is in the course of developing a data information system to enable the monitoring and tracking of returns and to ensure returns are submitted in a timely manner.

Penalties for late submission will be implemented.

The filing of annual financial statements by PORCs will be implemented from year ending 2003 and recommendation will be made to Executive Council to require the Chief Executive Officer and one director to sign the annual compliance statements.

- *Revise the Insurance Ordinance to allow SOI specific authority to hire a third party at the insurers expenses and include a provision to charge the company for any third party work or investigation.*
- *To require insurers to hire, using their own resources, independent auditors or actuaries for auditing or reviewing all or specific items of the financial statements whenever the insurance supervisor has doubts as to their accuracy.*

The authorities will introduce legislation to bring these recommendations into effect.

Core Principle 15—Cross Border Business Operations

We note the recommendations with regard transparency in procedures in place for refusing a foreign applicant a licence to establish in the Islands and again this recommendation will be addressed in the proposed procedure manual covering the licensing criteria for entities submitting licensing applications under the provisions of the Insurance Ordinance.

Core Principle 16—Co-ordination and Co-operation

We note your comments that the existence of requirements of several additional criteria could not be verified as there were many undocumented practices. Again these will be addressed when the procedure manuals and guidelines for the department are produced.

Core Principle 17—Confidentiality

We note your comments that the FSC has adequately addressed the confidentiality requirement. You have however, indicated that the FSC need to address the issue of sharing information with law enforcement agencies. We believe that the Confidential Relationships Ordinance provides a gateway for law enforcement to obtain information from the FSC and other entities when it is required for furthering their investigation.

C. AML/CFT Assessment

91. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations for Combating the Financing of Terrorism* (FATF 40+8 Recommendations) was prepared by a team⁷ of Fund staff, experts under the supervision of Fund staff, and an expert not under the supervision of Fund staff, who was selected by the authorities to assess matters concerning AML/CFT law enforcement. The report summarizes the level of observance of the FATF 40+8 Recommendations and provides recommendations to enhance observance. The views expressed in this report are those of the assessment team and do not necessarily reflect the views of the TCI authorities or of the IMF Executive Board.

Information and methodology used for the assessment

92. This assessment is based on a review of TCI AML/CFT legislation and regulations,⁸ as well as on the nonbinding guidance notes issued by the FSC and the MLRA with respect to institutions regulated by the Proceeds of Crime (Money Laundering) Regulations 1999 (PCMLR). The assessment team held discussions with the governor, senior officials from a number of TCI government departments and agencies, as well as with representatives of industry. The assessment is based on the information available at the time it was completed on February 13, 2003.

Main finding

93. The TCI has a robust, but rather complex legal, institutional, and supervisory regime for AML/CFT. The legal framework has undergone a major overhaul in the past four years, including several amendments that were introduced in response to critical remarks formulated by the report resulting from the *Review of Financial Regulations in the Caribbean Islands and Bermuda* [conducted by KPMG on behalf of the U.K. government] (“the KPMG Report”), as well as to other reports by various international fora. The adoption of the PCMLR in 1999 and the extension of the ATFOMOTO to TCI in 2002 created a sound legal basis for the AML/CFT regime, but the corresponding supervisory arrangements lack clarity and strength. TCI formally complies with the majority of the FATF 40+8 Recommendations, but significant shortcomings remain in key areas, such as, Recommendations 2, 14, 15, 20, 21, and 26. These shortcomings relate to the lack of clear

⁷ The assessment was conducted by Messrs. John Abbott (MFD), Peter Csonka (LEG), Ernesto López (AML/CFT Consultant, MFD), and Mr. Basil Collie (Royal Bahamas Police Force, The Bahamas), the independent anti-money laundering expert (IAE) on the team. Throughout this report, portions of the assessment attributable to the IAE are shown in italicized text.

⁸ See list attached.

requirements and/or compliance with regard to (1) verifying the identity of beneficial owners of business introduced by trustees and other corporate service providers, (2) reporting suspicious transactions (STRs), (3) monitoring unusual or complex transactions, (4) supervising effectively the compliance with AML/CFT regulations, and (5) confidentiality regulations preventing supervisory access to client information. The mission acknowledges that progress has been achieved in the past few years, but after a first phase of reactive legislation, it is now time to implement a genuine AML/CFT policy. This needs to be supported by a consolidated and clear legal framework to avoid overlaps and conflicting interpretations, as well as, by effective supervision, an FIU that meets the Egmont Group criteria, adequate staff and resources allocated to agencies involved in AML/CFT, aware, and collaborative industry. Without these additional efforts, TCI will continue to be exposed to the risk of its financial and corporate services being misused for illegal purposes.

Criminal justice measures and international cooperation

Criminalization of ML and FT

94. ML is criminalized in TCI in a manner broadly consistent with the Vienna and Palermo Conventions, even if the latter has not been ratified by the U.K., nor extended to TCI. The ML offenses extend to proceeds derived from all serious (indictable) offenses, the *mens rea* requirements are “knows or has reasonable cause to suspect,” self-laundering is covered, and corporate bodies can also be held liable for money laundering. However, as money laundering is criminalized by four statutes, and drug and nondrug ML regimes run parallel, issues of consistency arise. TCI, therefore, needs to harmonize and unify all applicable ML offenses, inter alia, by removing the distinctions between drug and nondrug ML and consolidating into one statute the dispersed provisions of TCI law, which governs the criminalization of ML. Separately, the PCMLR imposes criminal liability on the regulated entities for failure to establish and maintain appropriate internal AML controls, even though the ML definition in the PCMLR needs to be updated to reflect the currently applicable ML and FT laws.

95. FT is criminalized in TCI by the U.K. Statutory Instrument (the ATFOMOTO) based on the 1999 UN International Convention for the Suppression of the Financing of Terrorism, but the relevant Order in Council extending the application of the Convention to TCI has not yet been published. Adequate and dissuasive sanctions are available for persons who commit ML or FT offenses.

Confiscation of proceeds of crime or property used to finance terrorism

96. **Legal Provisions and Protections**—TCI’s law provides authority for courts to make value orders, which is to confiscate the value of the benefit derived from crime, including ML and FT. TCI officials claim that under general criminal law, they are able to confiscate instrumentalities used, or instrumentalities intended for use, in the commission of ML/FT offenses as well. Confiscation is mandatory and conviction-based under the PCO and CDTO. Currently, civil forfeiture is not possible but is being contemplated. However, courts can

forfeit drug or terrorist cash independently from criminal proceedings. TCI is also able to restrain crime-related property or terrorist funds subject to confiscation, though it is unclear to what extent funds or property belonging to terrorist organizations or to those who finance terrorism can be restrained. No specific measures are provided to facilitate the identification and tracing of property that is subject to confiscation, except in FT cases (monitoring orders). TCI's general confiscation regime lacks sufficient powers to enable the identification and tracing of criminal proceeds liable to confiscation. The compulsory powers currently available (production orders and search warrants) are designed to get disclosure of written records rather than to follow the money trail. TCI law does not specifically regulate the protection of the rights of bona fide third parties in connection with the exercise of these powers by the authorities, but certain protections exist.

97. To enhance the confiscation regime, it would help if the PCO were revised to (1) specifically provide for the confiscation of laundered property, even if intermingled with legal property, as well as of the instrumentalities used in or intended to be used for money laundering or financing of terrorist offenses, (2) extend the definition of proceeds to any property "derived from or obtained through" the commission of an offense in accordance with the Palermo Convention (Article 1-e), (3) allow, based on the U.K. Proceeds of Crime Act 2002, civil forfeiture orders to recover assets derived from any unlawful conduct in a nonconviction-based procedure, subject to ensuring legitimate rights to property, (4) provide for a range of powers that enable the tracing of proceeds following the model of the U.K. Regulation of Investigatory Powers Act 2001 (RIPA), including at a minimum account monitoring orders, (5) provide specifically protection for the rights of bona fide third parties, as set forth in the Palermo Convention (section 12–8) or Strasbourg Convention (section 22), and (6) make specific provision for declaring contracts that aim to frustrate confiscation orders void or voidable.

98. **Law Enforcement Considerations**—The laws governing asset forfeiture and money-laundering investigations in TCI are comprehensive. Interviews conducted of authorities at the attorney general's chambers and the FCU indicated that both units worked closely together and have accomplished notable successes in a number of money-laundering cases. Confiscation/forfeiture matters appear to be a priority of both agencies. A number of serious fraud-/money-laundering matters are presently subject to judicial proceedings in TCI. There are a number of restraint orders obtained by the FCU. It is important that the TCI amend the law to allow for all properties confiscated under the various ML/FT acts to be placed in a confiscated asset fund.

The FIU and processes for receiving, analyzing, and disseminating intelligence

99. **Functions and Authority**—At present, there is no FIU in TCI that meets the Egmont Group's definition. Section 27 of the PCO set up the MLRA to assist in receiving, analyzing, and disseminating disclosures of financial information, but the MLRA functions as a high-level coordination body, rather than as a real FIU. It seldom meets, it has no staff, and it receives only a negligible number of STRs. The FCU of the police, represented on the MLRA, functions as the day-to-day FIU and receives the majority of the STRs directly from

reporting entities. The STR reporting arrangements are unclear under TCI law, which does not specifically mandate the filing of suspicious transactions reports apart from cases of FT, even though large exemptions apply in this regard, too. The FCU conducts analyses of STRs and criminal investigations into money laundering, as well as shares information regularly with its foreign counterparts and cooperates with international investigative officers based in Miami (USA) through membership of WCCIT. However, since the FCU is not a member of the Egmont Group and has not concluded any MOUs with other FIUs, the network for information exchange is limited, particularly for exchanges with administrative FIUs. No formal arrangements authorize TCI law-enforcement authorities to conduct cooperative investigations or coordinated seizure-and-forfeiture actions with other jurisdictions. However, such cooperation is said to exist.

100. TCI could significantly improve the overall effectiveness of its AML/CFT regime by setting up an FIU that meets the Egmont Group's requirements and by explicitly compelling all regulated entities to report suspicions of money laundering. The authorities will need to ensure that the future FIU has access to any such information as may be necessary for analyzing STRs, has sufficient powers to order penalties for nonreporting, and the authority to disseminate financial information to other authorities, including foreign counterpart FIUs.

101. **Law Enforcement Considerations**—At present, the financial crimes unit of the TCI police force functions as the day-to-day FIU for the Island. However, this unit only has a compliment of one detective inspector, two sergeants, and one constable to investigate all major fraud matters, suspicious transaction reports, money-laundering matters, and request for assistance received from law-enforcement agencies worldwide. It is this assessor's view that this amount of work cannot realistically be properly investigated by such a small team. It is recommended that an additional four officers be added to this unit as soon as possible to increase its investigatory effectiveness. It is also recommended that a suitable person be appointed as the director of the FIU, and be given the manpower and resources to properly run the same. Regional assistance can be sought to accomplish this.

Law enforcement and prosecution authorities, powers, and duties

102. The FCU and the attorney general's chambers have responsibility for the investigation and prosecution of ML and FT, and the applicable laws give the authorities broad powers to compel the production of records through a court order to "make material available" in order to determine whether someone benefited from crime or the extent and whereabouts of the proceeds. Whereas the information cannot be disclosed if it is protected by legal privilege, secrecy or other restrictions are waived by production orders. Legal privileges include the attorney-client privilege, which covers communications made in connection with the giving of legal advice or in view of legal proceedings. More robust information-gathering methods (account monitoring orders) are only available in FT and other terrorism investigations.

103. **Law Enforcement Considerations**—The Proceeds of Crime Ordinance should be amended to allow for monitoring orders. An on-staff attorney to specialize in money-

laundering and asset forfeiture prosecutions should be attached to the FCU at its office. This would eliminate the constant need for the unit to have the attorney general's chambers prepare its production and court orders, and would also allow investigators and the attorney to work hand-in-hand with these complicated AML/CFT cases.

International cooperation

104. **Laws and Procedures**—TCI has both laws and informal arrangements that facilitate cooperation in AML/CFT matters, although the scope of the applicable statutes is limited to drug-related mutual legal assistance under the CJICO 1998 and to the enforcement of overseas confiscation orders under the PCODCTO 2001. A bilateral U.K.-U.S. MLAT extended to TCI by the MLAUO, and various U.K. statutory instruments dealing with the financing of terrorism in Overseas Territories provide further basis for mutual legal assistance. Mutual assistance from TCI, in general, does not require a treaty relationship (MLAT), but is subject to the principle of reciprocity. It follows that assistance cannot be given to a foreign state if the application relates to conduct that would not constitute an offense if it had occurred in TCI. Because there is no income tax levied in TCI, no assistance can be given to foreign states with regard to income-tax offenses occurring, or to be prosecuted in the foreign jurisdiction. The government has given an undertaking, subject to conditions, that it will introduce legislation to provide such assistance by 2005.

105. Overseas mutual assistance requests are channeled through the governor and the attorney general's chambers (non-U.S. related) or the chief magistrate (U.S. related). Law-enforcement assistance from TCI can be obtained through the police via ICPO-Interpol channels or informal arrangements.

106. The extradition of persons between TCI and Commonwealth countries is controlled by various orders made under the U.K. Fugitive Offenders Act 1967, and with other countries by the U.K. Extradition Act 1870, as amended, and the various treaties and orders made under that Act. In 2002, new extradition arrangements for crimes punishable with imprisonment of at least 12 months entered into force between the U.K., other Commonwealth countries, and OTs, including TCI, under a U.K. statutory instrument extended to TCI, the EOTO. These arrangements seem to apply to all principal ML and FT offenses, wherever committed in the countries and territories referred to. The U.K. has also extended the Extradition (Terrorist Bombings) Order 2002 to TCI, whereby the relevant extradition provisions of the International Convention for the Suppression of Terrorist Bombings were brought into effect. TCI is able to extradite its own nationals to other states.

107. **Statistics and Other Implementation Issues**—The TCI did not provide any statistics on the amount of assistance they rendered to countries, as a result of MLAT requests, or the number of countries who assisted TCI. Based on information received from TCI authorities, it would appear that assistance is provided in all forms of criminal matters, but in an informal way. There appears to be a very good police-to-police assistance rendered to law-enforcement agencies worldwide by the TCI. It would also appear that this

person-to-person contact has assisted greatly in the investigation of AML/CFT matters in TCI.

Preventive measures for financial institutions:

Prudentially-regulated sectors

108. **Regulated sectors**—The main sectors to which AML/CFT preventive measures apply are banking; insurance, mutual funds, and corporate and trust services. The same preventive regulations apply to any other “relevant financial business” listed in the regulations, which extend to money remitters, investment dealers and credit card issuers, among others, but not to currency exchange offices. While this coverage is extensive, given local vulnerabilities, it is recommended that: (1) the licensing and control requirements for investment dealers are effectively enforced; and (2) money remitters are subject to registration by the FSC.

109. **Supervision/enforcement**—The FSC licenses and exercises prudential supervision over banks, insurances, mutual funds, corporate and trust service providers, but not over other financial institutions. As part of its general functions, it performs “fit-and-proper” checking with regard to key officers, verifies that the institutions comply with the ordinances applicable to them and grants and revokes licenses. However, it cannot impose fines or other administrative penalties. The FSC does not have authority to enact administrative regulations to develop the AML regime.

110. The law does not provide the FSC (or any other authority) with specific powers to supervise compliance with AML/CFT regulations. Instead, it has a general function to “protect the public against financial loss arising out of the dishonesty, incompetence or malpractice of persons engaged in the financial services business.” Its oversight is also impaired by inadequate resources and strict confidentiality laws, which prevent the FSC from having access to customers’ personal information except in the banking sector. These weaknesses need to be addressed, by prompt amendment of the financial legislation and appropriate funding of the FSC.

111. **Preventive measures**—All the AML/CFT preventive measures are contained in the Proceeds of Crime Money Laundering Regulations 2000 (PCMLR), and their breach is considered a criminal offense. There are no other administrative provisions on AML/CFT, save for the non-mandatory guidance notes issued by the FSC and the MLRA. The mandatory regulations require the regulated entities to have procedures about (1) customer identification; (2) employee training; (3) record keeping; and (4) internal reporting of suspicious transactions, which formally comply with international standards. There are special provisions to protect a person who furnishes information to the competent authorities, and “tipping-off” is penalized. Additional efforts have been made to avoid the misuse of shell corporations by immobilizing bearer shares and requiring maintaining shareholder records within the jurisdiction.

112. Nevertheless, there are explicit exemptions and regulatory gaps in the AML/CFT regime that need to be corrected. Among the most relevant, are the following weaknesses:

(1) **STRs**—Banks have a general obligation to report a customer’s conduct “contrary to any law,” but a fully developed money-laundering, suspicious-transaction-reporting system does not exist, save for reports related to terrorist financing (although the regulated sector seems to be exempted from this duty); (2) **internal controls**—the AML/CFT regulations do not require implementing an internal control system for compliance, neither do the duties of “reporting officers” include regulatory compliance; (3) **identification**—there is no obligation to obtain evidence of customer identity where he is introduced by another regulated entity or acts on his behalf (this includes all trust and company service providers); (4) **record keeping**—it is enough to be able to obtain evidence of a customer’s identity (if so requested by the authorities), without actually keeping copies of any identification document; (5) **wires**—there are no provisions about the minimum information required for wire transfers, and it is not prohibited by law to open anonymous accounts (although banking practices normally meet the relevant standards in this area); (6) **monitoring**—no provision has been enacted about ongoing monitoring of accounts, detecting unusual or economically illogical transactions (the Guidance notes provide useful examples, though they are not mandatory); (7) **FIU**—a financial intelligence unit that meets the Egmont Group’s criteria for analyzing suspicious transaction reports, and capable of sharing information with other domestic and international agencies does not exist; (8) **branches**—AML controls are not necessarily applicable to foreign branches or subsidiaries of a domestic institution; and (9) there is no “fit-and-proper” screening of employees to ensure high integrity standards.

Nonprudentially-regulated sectors that are macro relevant

113. **Institutions already under AML obligations**—As stated earlier, investment dealers and money remitters are already subject to the general AML provisions but have no supervisory or regulatory authority. It is therefore necessary that arrangements be put in place to enforce compliance with AML/CFT provisions.

114. **Businesses not yet subject to AML obligations**—The inherent risks of being an off-shore financial center and having a strong cash culture in TCI make it necessary to implement preventive measures (and appoint authorities to enforce their compliance) for businesses such as gambling, jewelry stores, real estate brokers, and currency exchanges.

115. Among other mechanisms, it is recommended that measures be taken for requiring the reporting of suspicious transactions, prohibiting check payments in casinos, prohibiting the purchase of real estate or jewelry with cash above a certain threshold, and establishing a mandatory registration of currency exchanges. Guidance should be issued for financial institutions as to the special risks that these customers involve and how to minimize such risks. It is also recommended to enact specific provisions for mitigating the AML risk of currency exchanges, including registration, suspicious transaction reporting, and cash payment controls.

Summary assessment against the FATF recommendations

116. TCI formally complies with the majority of the FATF 40+8 Recommendations, but significant shortcomings remain in key areas, despite obvious government efforts to meet international standards. Consolidation of the existing ML statutes and review of the PCMLR in the areas indicated below are considered necessary to make the AML/CFT regime more robust. Supervision of the AML/CFT preventive framework also needs to become more systematic and effective to enhance its operational impact.

117. Revision Table 1 summarizes recommended actions in areas related to the FATF 40+8 Recommendations, while Table 2 contains other recommendations to further enhance the AML/CFT regime.

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

Reference FATF Recommendation	Recommended Action
Forty Recommendations for AML	
Scope of the Criminal Offense of Money Laundering (FATF 4–6)	Harmonize and unify ML provisions; update PCMLR and provide for adequate penalties, including license revocation for breaches.
Provisional Measures and Confiscation (FATF 7)	Amend PCO to allow confiscation of laundered property and instrumentalities. Provide adequate powers for tracing assets, including monitoring orders. Consider introduction of civil forfeiture.
General Role of Financial System in Combating ML (FATF 8–9)	Subject investment dealers and money remitters to registration. (already subject to AML/CFT). Implement AML/CFT preventive measures (and appoint authorities to enforce their compliance) for businesses such as gambling, jewelry stores, real estate brokers, and currency exchanges.
Customer Identification and Record-Keeping Rules (FATF 10–13)	Reduce or eliminate the exemption from identification requirements applicable to transactions made by, or through other regulated entities. Prohibit the establishment of anonymous or fictitiously named accounts. Allow supervisory access to all client’s information (even if confidential).
Increased Diligence of FIs (FATF 14–19)	Introduce AML/CFT reporting duty to report suspicious transactions. Lower the standard of suspicion to include unusual transactions and provide clear guidance that reporting entities need not suspect a specific predicate offense. Make it a legal obligation to monitor and detect unusual transactions. Create an FIU corresponding to Egmont criteria. Provide the MLRA with authority to define mandatory STR format and give mandatory directions to FI.
Implementation and Role of Regulatory and Other Administrative Authorities (FATF 26–29)	Provide the FSC with the authority, mandate and resources necessary to develop an adequate on-site and off-site supervision of compliance with any AML/CFT legislation. Give the FSC authority to develop AML/CFT legislation by enacting mandatory regulations.
Other Forms of Cooperation—Basis and means of cooperation in confiscation, mutual assistance, and extradition (FATF 33–35)	Expand CJICO to all indictable offenses and provide for enforcement of overseas orders for provisional and investigative measures; Initiate extension of MLAT with Canada to TCI.
Eight Special Recommendations on Terrorist Financing	
VII. Wire Transfers	Make it mandatory to include originator/recipient information on funds transfers.

Table 4. Other Recommended Actions

Reference	Recommended Action
Law Enforcement and Prosecution	Ensure adequate funding, training and staff for all law-enforcement agencies

Authorities’ Response: Anti-Money Laundering and Combating the Financing of Terrorism

Criminal Justice Measures and International Co-operation

I—Criminalization of ML and FT

Although the TCI is not technically bound by the Palermo Convention it has applied many of its provisions. The TCI Constitution does not give it powers to ratify international treaties and would require the UK to extend their application to TCI by Order in Council.

We will draw the attention recommendation to the attention of the United Kingdom’s Government.

We have noted your comments recommending that the TCI should update the Proceeds of Crime Ordinance to include in the Proceeds of Crime (Money Laundering) Regulations (PCMLR) the definition of money laundering offences as set out in the Criminal Justice (International Co-operation) Ordinance (CJICO) and the Anti-Terrorism (Financial and Other Measures) (Overseas Territories) Order 2002 (ATFOMOTO) and that penalties should include breaches and the revocation of a licence of a regulated entity.

We propose to take the recommendations forward to the Legislative Council.

11— Confiscation of proceeds of crime or property used to finance terrorism

We note your recommendation that the TCI authorities should amend the PCO to specifically provide for the confiscation of laundered property, even if intermingled with legal property, as well as of the instrumentalities used in or intended to be used for money laundering or financing of terrorism.

We do not concur. We consider the recommendation unnecessary in view of the general power of confiscation on conviction.

The TCI agree with the following recommendations that Proceeds of Crime Ordinance be amended to:

- extend the definition of proceeds to any property “derived from or obtained through” the commission of an offence in accordance with the Palermo Convention.

- provide specifically protection for the rights of bona fide third parties as set out in the Palermo Convention;
- include specific provision to declare contracts that aim to frustrate confiscation orders void or voidable.

III—The FIU (sic) and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels.

The TCI authorities concur with the recommendation that a FIU should be established that meets the Egmont Group requirements. The authorities also concur that regulated entities should be required to report all suspicious transactions reports to the FIU.

IV—Law Enforcement and prosecution authorities' powers and duties

The recommendation that the authorities should ensure adequate funding, staffing and training for all law enforcement agencies has been noted and is being addressed as an ongoing project.

V—International Co-operation

The authorities have noted the IMF recommendation that the CJICO should be amended to apply to all indictable offences specifically enforcement of overseas tracing, production and monitoring orders and amend the said ordinance to authorise co-operative investigations and asset sharing with overseas jurisdictions.

Legal and Institutional Framework for Financial Institutions

1 —General Framework

The TCI authorities concur with recommendation that the investment dealers and money remitters should be subjected to the provisions of the legislation covering anti-money laundering and combating the financing of terrorism measures and in these activities are covered in the PCMLR in Schedule 1 under “Relevant Financial Business Activities”.

With regard to the recommendation that cash intensive businesses such as gambling, jewellery stores, real estate brokers and currency exchanges a study is being carried out to ascertain the level of activities in each sector following which consideration will be given to introduce legislation where there is significant business activity.

Concerning the recommendation that legislation should be enacted to provide the FSC with discretionary powers to obtain, without a Court Order, any type of information held by the regulated institutions, including confidential information about their customers or information subject to any privilege, legislative approval will be sought to give effect to the recommendation.

II—Customer Identification

We concur with the following recommendations and will introduce amendments to the relevant legislation:

- To make it mandatory for all relevant financial businesses to verify the identity of their accounts and to reduce the exemption from identification requirements applicable to transactions made by, or through other regulated entities.
- to permit supervisory access to all clients' information;
- to require institutions to include originator information on funds transfers;

The banking sector has reported that there are no institutions in the TCI operating anonymous accounts. However, we will seek legislative approval to prohibit creation of such accounts in the future.

III—Ongoing monitoring of accounts and transactions

Concerning the recommendation that the authorities make it mandatory that financial institutions be required to monitor, detect and analyze unusual transactions and to give enhanced scrutiny to wire transfers that do not contain complete originator information, TCI confirms that although these are currently in the Anti-Money Laundering Guidelines we will now seek legislative approval to introduce these enhancements.

The recommendation that a list of general and objective alerts for each regulated sector should be introduced based on parameters such as money thresholds, risk jurisdictions, politically exposed persons, common laundering schemes the TCI authorities have undertaken to include these alerts in the revised money laundering guidelines.

IV—Record Keeping

The TCI authorities concur with your recommendation that:

- FSC, the MLRA and the FIU when established should be allowed access to all records and customer files, even before judicial proceedings are initiated;
- That the PCMLR should be amended to require the keeping of all records, including –
 - the customer's and beneficiary's name, address or other identifying information normally recorded by the intermediary
 - the nature and date of the transaction
 - the type and amount of currency involved

- the type and identifying number of account involved
- that the PCO be amended to make mandatory the keeping of identification records as the current legislation is restricted to keeping instructions on how and where to obtain identification evidence.
- to make provisions that all financial institutions be required to monitor, detect and analyze unusual transactions and to give enhanced scrutiny to wire transfers that do not contain complete originator information.

V—Suspicious transactions reporting

The authorities concur with IMF recommendation also the recommendation in the revised FATF 40 Recommendations that legislative changes should be introduced to make mandatory the reporting of suspicious transaction and to provide the MLRA with authority to define mandatory suspicious transactions reporting format and give directions to financial institutions.

VI—Internal controls, compliance and audit

The TCI authorities do not agree that the PCMLR be amended to make mandatory the range of regulatory compliance controls recommended. It will create undue burden on small businesses where the level of activity does not warrant the system of internal control indicated.

We do however concur that where a compliance officer is appointed in a regulated entity that the person should be approved by the Licensing Committee of the FSC and that regulated institutions should submit to the FSC annual audited reports of regulatory compliance with AML legislation.

VII—Integrity standards

Concerning your recommendations that Investment Dealers and Money Remitters should be licensed and supervised by the FSC, please note Investment Dealers Regulations was introduced at the end of June 2003 and draft legislation is being prepared to regulate Money Remitters.

VIII—Enforcement powers and sanctions

We concur with the recommendations made concerning enforcement powers and sanctions and confirm:

- that a decision has already been taken to provide the FSC with the authority, mandate and resources to develop an adequate on-site and off-site supervision programme which would ensure compliance with AML/CFT laws and regulations applicable to supervised entities.

- steps will be taken to identify the appropriate authorities for the enforcement of controls in the sectors not currently under FSC supervision, such as gambling and real estate.

Money remitters are likely to be designated under FSC's control. However, there are no entities licensed under the Business Licensing Ordinance to carry out currency exchange activity in the Islands.

Concerning the Governor's regulatory powers under sections 26 and 32 of the PCO, the regulatory powers are those of the Governor in Council which is the executive arm of government that has the power to introduce regulations prescribed under legislation. We do not wish to make any changes in this regard.

IX—Co-operation between supervisors and other competent authorities

As already mentioned we concur with the recommendation that the authorities should establish an FIU that meets with Egmont Group criteria.

With regard the sharing of information at supervisory level, the Banking, Insurance and Trustee Licensing Ordinances make provision for Superintendents to exchange information with overseas regulatory authorities without recourse to the Licensing Committee. It may however, be necessary to introduce similar provisions in the Mutual Fund and Investment Dealers Ordinances.

The recommendation that FSC should be given adequate resources as detailed in the Basel Core Principles Assessment has been addressed.