

CONSULTATION PAPER

DEVELOPING ANGUILLA'S INVESTMENT BUSINESS

**MEASURES TO INTRODUCE THE REGULATION OF INVESTMENT BUSINESS
AND TO ENHANCE
THE REGULATION OF MUTUAL FUNDS**

1. INTRODUCTION

- 1.1 Currently, non-domestic mutual funds are regulated by the Commission under the Mutual Funds Act, R.S.A. c. M107 (“Mutual Funds Act”) and domestic investment business is regulated by the Eastern Caribbean Securities Regulatory Commission (“ECSRC”) under the Securities Act, R.S.A. c. S13 (“Securities Act”).
- 1.2 A regulatory gap allows Anguillian companies to carry on other types of non-domestic investment business without the regulatory supervision of the Commission, the ECSRC or any other financial regulator. This legislative lacuna presents both a significant risk to the reputation of Anguilla and a missed opportunity to develop further the financial services industry on the island.
- 1.3 The Caribbean Financial Action Task Force (CFATF) Mutual Evaluation Report (“MER”) on Anguilla in 2010 identified one licensed securities broker-dealer, regulated by the ECSRC under the Securities Act, and one unregulated securities broker-dealer.
- 1.4 However, the Commission is aware of a number of unregulated investment businesses, including entities organized under the Companies Act, Limited Partnership Act and Limited Liability Company Act. The business of these entities includes day trading and foreign exchange (“forex”) trading.
- 1.5 The US Commodity Futures Trading Commission and the North American Securities Administrators Association have warned that off-exchange forex trading by retail investors is at best extremely risky, and at worst, outright fraud. They caution that investors should make sure that anyone offering a forex investment is properly licensed and has a reputable business history.
- 1.6 In May 2012, the Commission surveyed the financial services industry to determine involvement by Anguillian entities in the investment business. Only a dozen service providers responded and, of those, only four reported clients conducting investment business. Notably, the registered agents for the businesses identified in paragraph 1.4 did not respond to the survey and the information, where provided, was not sufficient to draw meaningful conclusions.

1.7 This paper sets out:

- a) the activity that would be captured by the regulatory regime,
- b) how the Commission would supervise it,
- c) the powers that would need to be given to the Commission to enable it to supervise it effectively,
- d) what transitional periods would be afforded to businesses to adjust to the new standards, and
- e) how a business would obtain licensed status.

1.8 The paper invites comments from the industry and other stakeholders. The paper also explains the consultation process by which the Commission will ensure it listens to and understands the needs of the industry in order that it may be best positioned to recommend a regime to the House of Assembly that will meet international standards whilst also providing a legislative framework within which industry can grow.

1.9 Industry and other stakeholders are encouraged to engage in this consultation process and pass their comments to the Commission. Respondents are asked to answer the specific questions as well as provide their own comments on each section.

QUESTION 1

Do you understand the importance for the island to meet international standards and that this will involve plugging any regulatory gaps?

Yes _____ **No** _____

QUESTION 2

Do you understand how these measures will also help keep industry standards high, encourage professionalism and protect the interests of the investing public?

Yes _____ **No** _____

2. OVERVIEW

- 2.1 The proposed framework envisages a law which starts by setting out what activity will be "captured" by the regime. The domestic securities sector is regulated by the ECSRC under the Securities Act. Recently-enacted regulations relating to externally and non-regulated service providers give the Commission AML/CFT supervisory responsibilities over Anguillian investment businesses licensed by the ECSRC and non-licensed investment business. By regulating the currently-unregulated securities sector, the Commission will extend its AML/CFT supervisory responsibilities to a new area of *licensees* and, in the result, Anguilla will be able demonstrably to meet international standards.
- 2.2 The securities sector covers a wide range of activities including those of persons who arrange, advise, manage or deal in investments. Sometimes, professionals will control client assets either to fulfill deals on the basis of instruction, or on the basis of a discretionary portfolio management agreement. On other occasions, professionals will not control client assets and will limit their activities to advising investors or potential investors of opportunities that may be suitable for them. Some professionals will be independent and able to survey the market to find the best product for a particular client; some will be limited to the range of products or services offered by the company for whom they work. Some will be remunerated on the basis of fees, others on the basis of commission. All these variations can be accommodated within the regime.
- 2.3 People who invest their own money (i.e., are acting as principal) will be exempted from the regulatory regime. This includes directors of private investment holding companies, or council members of investment holding foundations.
- 2.4 The second area of the non-domestic securities sector which the international standard setters believe requires a formalised approval and oversight process relates to pooled investment funds. These investment business products are commonly known as "collective investment schemes" (e.g., under the Securities Act) or "mutual funds" (e.g., under the Mutual Funds Act). The funds may be formed in Anguilla and marketed locally or internationally, or they may be formed overseas and marketed into the island, either by overseas professionals or by local businesses. They may be geared to appeal to retail investors or have high minimum investment levels and only be appropriate for sophisticated investors.
- 2.5 "Domestic" collective investment schemes and "non-domestic" mutual funds are regulated respectively, by the ECSRC under the Securities Act and by the Commission under the Mutual Funds Act. The proposed framework would keep the regulation of non-domestic

mutual funds in a separate statute, the Mutual Funds Act, rather than consolidating the regulation of mutual funds into a single investment business statute.

- 2.6 Currently, investment advisers are not directly licensed under the Mutual Funds Act, although a licensed fund manager may provide a mutual fund with investment advice together with management services. The Commission proposes that the regulation and supervision of investment advisers to mutual funds be strengthened through the creation of a licensing regime. This regime would be set out in the proposed investment business legislation and the licensing would extend to advising in investments including, but not limited to, mutual funds.
- 2.7 The Commission has identified an opportunity to make the overall legislative framework compliant with the Alternative Investment Fund Managers Directive (AIFMD). AIFMD regulates so-called alternative investment fund managers and how they manage their funds. Hedge funds, private equity funds and real estate funds are examples of alternative investment funds. An AIFMD-compliant framework would be attractive to the European Union and create a business opportunity for Anguilla.
- 2.8 In 2012, the Commission received two inquiries relating to setting up a securities exchange. While the proposed framework may provide a basis for the Commission to licence and supervise securities exchanges, the Commission is mindful of the capacity of both the financial services industry and the Commission to supervise investment business effectively, at least in the short term. Where the Commission does not have the capacity to regulate an activity, a prohibition on that activity may be created by law.
- 2.9 International standards require legislative provisions relating to the prevention, detection or investigation of insider dealing and market manipulation. The proposed framework will provide a basis for the Commission to secure oversight of these activities and, importantly, to extend international cooperation to overseas regulatory authorities that may be carrying out investigations of their own, including the International Organization of Securities Commissions.
- 2.10 In addition to these areas of the securities sector which need to be brought within the regulatory framework, Anguilla will be expected to meet the international standard in the areas of protecting the securities sector and the public who invest in it from those who make false and misleading statements in securities matters. Accordingly the draft provisions will introduce the offence of dishonesty to clients.

QUESTION 3

How many investment businesses (those who arrange, advise, manage or deal in investments) do you think operate through Anguillian entities? This definition would include financial advisers, broker/dealers, forex traders, asset managers, and lawyers or accountants or tax advisers who give investment advice, manage assets or arrange investments (other than as principal).

0-20 20-40 40-75 76-100 100-125 125+

QUESTION 4

Do you think it is reasonable for investment businesses to be required to give suitable advice to their customers?

Yes _____ No _____

QUESTION 5

Do you think it is reasonable that an investment professional should have to disclose the fees and commissions he or she will earn from that deal to his or her customer so that the customer is aware of what their money is being spent on?

Yes _____ No _____

QUESTION 6

Do you think it is reasonable to prohibit certain activities where the Commission lacks the capacity to regulate those activities?

Yes _____ No _____

3. SUPERVISION

HOW WILL THE COMMISSION SUPERVISE THE SECURITIES SECTOR?

3.1 In discharging its functions, the Commission may take into account:

- a. the protection of the public, whether within or outside Anguilla, against financial loss arising out of the dishonesty, incompetence, malpractice or insolvency of persons engaged in financial services business in Anguilla,
- b. the protection and enhancement of the reputation of Anguilla as a financial services centre, and
- c. the deterrence of financial crime.

3.2 When members of the general public seek to save money for their futures, perhaps to provide for themselves in old age, or to fund children's education, or to buy their home, or to save for a special family event such as a wedding, it is not unreasonable that they expect the Commission to be protecting their interests. The public has a right to expect that a financial services firm is solvent, competent and properly managed by people of integrity who will properly assess their needs and give them truthful investment advice that is suitable for their personal circumstances and investment objectives.

3.3 Accordingly, the new regulatory regime will permit the Commission to license investment businesses when it is satisfied that a firm is solvent, competent and that it is owned and managed by people with integrity. An application process will clearly state what information is required to assist the Commission in forming this assessment. Businesses may be small or large, but will be expected to be able to demonstrate they are soundly run, have good systems and controls and keep proper records. Fundamental issues such as segregation of client money and disclosing fees and charges will be central to the regime.

3.4 Firms will be invited to apply for such of the transitional arrangements as they need. Extra time will be given to comply with the capital and solvency requirements, qualifications, client file reviews, etc. While a firm is working through the transitional arrangements, it will be able to carry on doing business as a transitional applicant. Once all standards are fully met, it will be granted licensed status.

3.5 This approach will allow Anguilla to introduce a regulatory framework quickly and thus meet international standards whilst still providing local businesses with plenty of time to adjust to the new regime and meet the standards necessary.

3.6 Transitional applicants can expect an onsite visit from the Commission or, where the transitional applicant is off-island, a video or telephone conference call to be followed by a face-to-face meeting with the applicant's principals prior to licensing. This should enable the

regulator to get a “feel” for the business and to gain confidence about issuing a license. Once authorised, fully licensed businesses can expect onsite or offsite examinations from time to time, as currently experienced by other regulated financial services businesses in Anguilla and around the world.

3.7 In between examinations, the Commission will keep a "watching brief" on the progress of its various licence holders by analysing the audited accounts and, if the investment business is dealing in investments, analysing periodic returns which will demonstrate the business is complying with the solvency margins necessary to manage exposures such as position and settlement risk.

3.8 In summary, the Commission will supervise the sector first, by applying a sensible licensing procedure with generous transitional periods; second, by conducting on-site examinations to check compliance with the regime and ensure the firm is running soundly; third, by analysing information regarding the financial controls and financial performance of the regulated entity.

QUESTION 7

Do you think it is reasonable that licences should be granted on the basis of an investment business firm being solvent, competent and owned/managed by people with integrity?

Yes _____ No _____

QUESTION 8

Do you think it is helpful to have transitional periods available to give a business time to meet the necessary standards?

Yes _____ No _____

4. POWERS

WHAT POWERS WILL BE GIVEN TO THE COMMISSION TO ENABLE IT TO SUPERVISE THE INVESTMENT SECTOR EFFECTIVELY?

4.1 The proposed law will include the standard set of powers any financial services regulator is expected to have. In particular, the proposed law will include powers which will enable the Commission to:

- a) evaluate an application and, where necessary, ask for further information
- b) issue a licence with or without conditions
- c) approve principal persons (directors or shareholders)
- d) object to the appointment or continuing of the appointment of principal persons
- e) approve key persons (compliance officers, for example)
- f) issue directives
- g) issue public statements
- h) conduct investigations
- i) appoint reporting professionals
- j) carry out compliance oversight through onsite visits and offsite analysis
- k) cooperate with other supervisory bodies
- l) conduct investigations on behalf of other supervisory bodies
- m) require audited accounts to be produced and submitted
- n) require (in some cases) essential financial data to monitor financial risk management is being done ~ for example in the case of broker/dealers
- o) revoke licences
- p) issue administrative penalties.

4.2 Some of the powers set out above are already included in the Financial Services Commission Act, R.S.A. c. F28 (“FSC Act”), as amended. Section 48A of the FSC Act permits a person who is aggrieved by a decision of the Commission, within 28 days of the date of the decision, to apply to the Court for leave to appeal against the decision. An appeal against the refusal of the Commission to grant a licence, or against a decision of the Commission to grant a licence subject to conditions, may only be made on a question of law.

QUESTION 9

Do you think the list at 4.1 above is a reasonable list of powers that would enable a financial services regulator to fulfil its function effectively?

Yes _____ No _____

5. TRANSITIONAL PERIODS

WHAT TRANSITIONAL PERIODS WILL BE AFFORDED TO BUSINESSES TO ADJUST TO THE NEW STANDARDS?

- 5.1 As mentioned earlier, the idea of transitional provisions is to create a mechanism by which firms can apply for their licence early and carry on with their business life while the Commission has time to evaluate the applications. In this respect it is similar to a "window" during which businesses can make their application.
- 5.2 However, experience shows that this kind of "window" can introduce a great deal of pressure into the system as many firms leave it until the absolute last moment to submit their application and the Commission is desperately chasing down missing information in an effort to avoid pushing the applicant into a state of unauthorised activity.
- 5.3 In a bid to break this habit and provide both industry and regulator with a more elegant solution, introducing transitional periods is being considered. This will give firms time to meet the new standards without disadvantaging them commercially.
- 5.4 It is proposed that the new law would come into effect on, say, 1 January 2015. Applicants would have to make a short form application by 1 February 2015, the objective of which will simply be to declare themselves to the Commission and provide very basic information as to who they are, where they are located, the type of business they undertake and which transitional provisions they wish to elect to enjoy (examples of transitional provisions are set out in section 5.8 below). The Commission will acknowledge applicants and confirm they are a "transitional applicant within the law."
- 5.5 At this point, the law is in force and, other than the areas where transitional provisions were offered, the regulatory regime applies (for example, if an investment business advisor lied to his client about an interest rate, an offence would have been committed). The applicant would receive a more comprehensive application form going into rather more detail about their business and this would be submitted within a further two months.
- 5.6 Meantime, the investment business name appears on the Commission website as a transitional applicant and it is permitted to carry on conducting its business until such time as the Commission makes a decision about its application. The Commission will make its best efforts to ensure that the licensing decision is made no later than 12 weeks after the expiry of the last transitional period, provided that a complete application has been made to the Commission on or before the expiry of the last transitional period.

5.7 At any time, a transitional applicant can ask his application to be determined if he is in a position to confirm that all the matters with regard to which he elected a transitional period, are now fully compliant.

5.8 A range of transitional provisions will be extended with regard to the new standards (many of which, it is recognised, firms will already have adopted). These include:

- a) capital adequacy and solvency -The proposed paid up share capital requirements are US\$25,000 to US\$100,000 for businesses that **do not** control client assets and US\$250,000 that **do** control customer assets. The proposed solvency test will supply a calculation proforma that sets out how certain assets, creditors and debtors are to be treated.
- b) professional indemnity insurance ~ in exchange for keeping capital and solvency levels low, (and therefore not presenting a barrier to licencing for the smaller business) comprehensive professional indemnity insurance will be required by all market participants to ensure customers are protected from the financial consequences of professional error. Where a firm factors in a significant excess, to reduce its policy premium, an appropriate figure will need to be added to the solvency calculation.
- c) qualifications, experience and continuing professional development.
- d) span of control (two independent, competent people are required to direct businesses that do not control client money, whilst three in firms that do. This is known as the "four and six eyes" principle).
- e) audit of financial statements -audited accounts will be required 3 months after the year end.
- f) appointment of a compliance officer, money laundering compliance officer and money laundering reporting officer.
- g) introducing key controls for new business - such as a "fact find" geared to establishing a profile of the customer, including his or her risk appetite, prior to giving advice or making arrangements, and a "reasons why letter" which sets out recommendations in writing and explains the reasons why certain recommendations will, in the opinion of the adviser, meet the needs of the customer.

- h) upgrading existing (current) customer records and agreements - conducting a file review to ensure all historical documentation is properly held on file including safeguarding and segregating any assets in a manner compliant with the codes of practice and customer assets regulations, and ensuring client agreements are compliant with the new regime.

- i) corporate governance, establishing a regular and sensible board meeting programme to ensure the proper running of the company.

QUESTION 11

What other transitional provisions do you think would assist the industry adjust to the new regulatory regime?

QUESTION 12

Notwithstanding, of course, the natural desire for maximum leeway, what do you think would constitute reasonable transitional periods for the areas identified in 5.8?

QUESTION 13

If you, or entitites for which you provide company management or other services, are carrying on investment business, would the business(es) need transitional provisions in these kinds of areas or do you think the business(es) are likely to be largely compliant already?

Need them all _____ Will need some _____

Will need a few _____ Won't need any _____

6. HOW WILL A BUSINESS OBTAIN LICENSED STATUS?

- 6.1 As set out in 5., above, an investment business needs to apply, will be acknowledged as a suitable applicant and will then appear on the Commission website as being able to carry on conducting business. In the application, the business can elect which transitional provisions it wants to enjoy to give it a bit more time to plan its compliance with the new regime.
- 6.2 As soon as all transitional provisions are no longer needed, the Commission will determine the application.
- 6.3 If a business gets to the end of the transitional provisions period and is still not able to demonstrate compliance, the applicant and the Commission will have to commence discussions to determine whether compliance is achievable and if not, commence cessation of business proceedings either by way of winding up or perhaps merger with another business if that would create sufficient mass to better support the systems and controls necessary moving forward.
- 6.4 In other jurisdictions where this kind of application process has been adopted, the transitional periods have helped industry immensely, enabling them to focus on specific areas and "tick them off" in a steady march towards achieving fully licensed status.

7. HOW TO PROVIDE COMMENT

- 7.1 This consultation paper is being circulated for comment to licensed company managers and trust companies, the Anguilla Financial Services Association, the Society of Trust and Estate Practitioners, the Joint Financial Services Legislation Committee, the Bar Association and other stakeholders.
- 7.2 Please print off a copy of this consultation document and write onto it your responses to the set questions contained herein. You may attach any further comments you wish to make by way of a covering letter. Please refer to the consultation document paragraph numbers, or question numbers, if your comments relate to specific sections.
- 7.3 Please email your comments to info@fsc.org.ai
- 7.4 Comments must be received by **midnight, 30 April 2014** in order to ensure that they will be considered.