BERMUDA MONETARY AUTHORITY

Investment Business Act 2003

Statement of Principles

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Statement of Principles

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Pursuant to Section 9

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Investment Business Act 2003
Section 9: Statement of Principles

Introduction

This Statement of Principles ("the Principles") is made pursuant to section 9 of the Investment Business Act 2003 ("the Act") which requires the Bermuda Monetary Authority ("the Authority") to publish in such manner as it thinks fit a statement of principles in accordance with which it is acting or proposing to act:

(a) in interpreting the minimum criteria specified in the Second Schedule to the Act and the grounds for revocation specified in section 21;
(b) in exercising its power to grant, revoke or restrict a licence; and
(c) in exercising its power to obtain information, reports and to require production of documents.

The Principles are of general application, and seek to take account of the wide diversity of investment providers that may be licensed under the Act and of the prospect of institutional and market changes. Notwithstanding, there is likely to be a need for the Principles to be revised and developed over time. If the Authority makes a material change in the Principles, section 9(2) of the Act provides that the change is to be published or a revised version of the Principles issued. The Principles should be read in conjunction with the relevant Codes of Conduct which are issued pursuant to section 10 of the Act and which prescribe certain standards for the effective control of business by investment providers and for the fair treatment of their clients.

PART 1 Explanation for the Statement of Principles

1.1 The Principles are relevant to the Authority's decisions on whether to licence an investment provider or to revoke or restrict a licence. The Authority's interpretation of the minimum licensing criteria in the Second Schedule and of the grounds for revocation in section 21 of the Act, together with the principles underlying the exercise of its powers, encapsulate the main standards and considerations to which the Authority has regard in conducting its supervision of investment providers. The functions of investment business supervision include monitoring the ongoing compliance of investment providers with these standards and identifying any threats to the interests of clients. If there are concerns, the Authority considers what steps should be taken to protect clients. Where appropriate, it seeks remedial action by persuasion and encouragement. However, if the Authority considers that its powers are exercisable and should be exercised in the interests of clients and potential clients, it may impose restrictions on a licence and, ultimately, revoke a licence.

1.2 Part 2 of the Principles considers the interpretation of each of the licensing criteria in the Second Schedule to the Act. Part 3 sets out the considerations relevant to the Authority's exercise of its discretion to grant a licence. Part 4 considers the interpretation of the various grounds for the revocation of a licence in section 21 of the Act. Part 5 sets out the principles underlying the exercise of the Authority's discretion to revoke or impose restrictions on a licence and to intervene in emergency situations. Part 6 sets out the principles underlying the exercise of the Authority's power to obtain information and reports and to require the production of documents.

PART 2 Second Schedule: Minimum Licensing Criteria

2.1 Introduction

Before an investment provider may be granted a licence the Authority has to be satisfied that all the criteria in the Second Schedule to the Act are or are capable of being fulfilled by the applicant on an ongoing basis. Once licensed, all investment providers are subject to the Authority's continuing supervision and regulation. Investment Providers are required to submit, at intervals determined by the Authority, financial and other information about their business.

While the Act sets out in broad terms the criteria which must be fulfilled by investment providers, these criteria are interpreted and applied in the context of the particular circumstances of individual businesses, and developments in the sector generally. In addition to reviewing submissions and other data received from investment providers, the Authority's supervision involves detailed discussions with investment providers' senior management on a regular basis. The Authority determines the frequency of those discussions. Meetings may take place either at the Authority's offices or at the licensee's own premises. In addition, compliance visits are routinely made to the premises of investment providers to add to the Authority's understanding of the licensee's management structures, operations, policies and controls and to assist it in satisfying itself that each investment provider continues to conduct its business prudently and in accordance with all relevant criteria.

This part of the Principles sets out the Authority's interpretation of the statutory licensing criteria.

2.2 Second Schedule Paragraph 1: "Controllers and officers to be fit and proper persons"

Controllers and officers

2.2.a. This paragraph provides that every person who is or is to be a controller or officer (as defined in the Interpretation Section of the Act) of an investment provider is to be a fit and proper person to hold that position. With regard to an individual who is, or is to be, a controller or officer the relevant considerations include whether the person has relevant experience, sufficient skills, knowledge, and soundness of judgment properly to undertake and fulfill their particular duties and responsibilities. The standards required of persons in these respects will vary considerably, depending on the precise position held by the person concerned. Thus, a person could be fit and proper for one position but not be fit and proper for a position involving different responsibilities and duties. The diligence with which the person is fulfilling or is likely to fulfill those duties and responsibilities is also considered, so that the Authority can assess whether the person does or will devote sufficient time and attention to them.

2.2.b. The Authority sees the standards as being particularly high in the case of those persons with primary responsibility for the conduct of an investment provider's affairs, taking into account the nature and scale of its business.

2.2.c. In assessing whether a person has the relevant competence, soundness of judgment and diligence, the Authority considers whether the person has had experience of similar responsibilities previously, the record in fulfilling them and, where appropriate, whether the person has appropriate qualifications and training. As to soundness of judgment the Authority looks to the person's previous conduct and decision taking.

2.2.d. The probity of the person concerned is very important: it is essential that a person with responsibility for the conduct of investment business is of high integrity. In contrast to the fitness elements of this criterion which reflects an individual judgment relating to the particular position that the person holds or is to hold, the judgment of probity reflects much more of a common standard, applicable irrespective of the particular position held.

2.2.e. Specifically, the Authority takes into account the person's reputation and character. It considers, inter alia, whether the person has a criminal record; convictions for fraud or other dishonesty would clearly be particularly relevant. The Authority also gives particular weight to whether the person has contravened any provision of banking, insurance, investment, trust or other legislation designed to protect members of the public against financial loss, due to dishonesty, incompetence or malpractice. In addition, it considers whether the person has been involved in any business practices appearing to the Authority to be deceitful or oppressive or improper or which otherwise reflect discredit on his

or her method of conducting business. In addition to compliance with statutory provisions, the Authority also considers a person's record of compliance with various non-statutory codes in so far as they may be relevant to the licensing criteria and to the interests of clients and potential clients.

2.2.f. The Authority also takes into consideration whether the person has been censured or disqualified by professional or regulatory bodies, e.g. The Bermuda Bar Association, The Institute of Chartered Accountants of Bermuda, The Bermuda Stock Exchange or corresponding bodies in other jurisdictions. Those who have are unlikely to be acceptable.

2.2.g. While any evidence of relevant past misconduct needs to be taken into consideration, the Authority recognises that lapse of time, and a person's subsequent conduct, are factors which may be relevant in assessing whether the person is now fit and proper for a particular position.

2.2.h. Once an investment provider is licensed, the Authority has continuing regard to the performance of the person in the exercising of his or her duties. Imprudence in the conduct of a licensee's business, or actions which have threatened (without necessarily having damaged) the interests of clients or potential clients will reflect adversely on the competence and soundness of judgment of those responsible. Similarly, failure by an investment provider to conduct its business with integrity and professional skills will reflect adversely on the probity and/or competence and/or soundness of judgment of those responsible. This applies whether the matters of concern have arisen from the way the persons responsible have acted or from their failure to act in an appropriate manner. The Authority takes a cumulative approach in assessing the significance of such actions or omissions – that is, it may determine that a person does not fulfill the criterion on the basis of several instances of such conduct, which, if taken individually, may not lead to that conclusion.

2.3 Shareholder Controllers

2.3.a. Shareholder controllers may hold a wide variety of positions in relation to an investment provider, and the application of the fit and proper criterion takes account of this. The key consideration is the likely or actual impact on the interests of clients and potential clients of a person holding the particular position as controller. This is viewed in the context of the circumstances of the individual case, and of the particular position held. The general presumption is that the greater the influence on the investment provider the higher the threshold will be for the controller to fulfill the criterion. Thus, for example, higher standards will generally be required of a majority shareholder controller (i.e. one owning 50 per cent or more of the shares of an investment provider) compared with a shareholder controller owning 10 per cent.

2.3.b. In considering the application of the criterion to shareholder controllers or persons proposing to become such controllers, the Authority has regard to two main considerations.

2.3.c. First, it considers what influence the person has or is likely to have on the conduct of the affairs of the investment provider. If the person does, or is likely to, exercise a close control over the business, the Authority would look for evidence of the probity and soundness of judgment and relevant knowledge and skills necessary for running a business prudently. On the other hand, if the shareholder does not, or is not likely to, influence the directors and management of the investment provider in relation to the detailed conduct of the business, it would not be necessary to require such a level of relevant qualities and experience. The Authority also has regard in this context to whether there could be conflicts of interest arising from the influence of the shareholder on the investment provider– this could, for example, arise from the closeness of his links with another company.

2.3.d. The second consideration is whether the financial position, reputation or conduct of the shareholder controller or prospective shareholder controller has damaged or is likely to damage the investment provider through 'contagion' which undermines confidence in it. For example, if a holding company, or a major shareholder, were to suffer financial problems it could damage confidence of clients or potential clients in the stability or financial integrity of the licensed entity. Generally, the higher the shareholding the greater the risk of 'contagion' if the shareholder encounters financial difficulties. The risk of contagion is not, however, confined to financial weakness: publicity about illegal or unethical conduct by a holding company or another member of the group may also damage confidence in the investment provider.

2.3.e. In the case of a controller who 'directs' or 'instructs' a shareholder controller similar considerations apply to those relevant to assessing the fulfillment of the criterion in relation to shareholder controllers. In other words, the standards that an indirect controller needs to satisfy are likely to be at the minimum the standards also required of the person who is indirectly controlled.

2.3.f. Where a person is a controller by virtue of 'directing' or 'instructing' the board of an investment provider, the standards required are high. The controller has to have the relevant knowledge, experience, skills and diligence for running an investment provider. The qualities required are those which are also appropriate for the board of directors of an investment provider.

2.4 Second Schedule Paragraph 2: "Business to be directed by at least two individuals"

2.4.a. This criterion – sometimes known as the 'four eyes' requirement – provides that, in the case of a company, partnership or unincorporated association of persons, at least two individuals must effectively direct the business of the investment provider. In the case of a company, the Authority normally expects that the individuals concerned will be either executive directors or persons granted executive powers by, and reporting immediately to, the board. In the case of a partnership, the Authority would expect at least two partners to exercise day-to-day control and oversight.

2.4.b. When this criterion applies, the Authority requires that at least two independent minds be applied to both the formulation and implementation of the policies of the investment provider. The Authority does not regard it as sufficient for one of the two persons to make some, albeit significant, decisions relating only to a few aspects of the business. Each must play a part in the decision-making process on all significant decisions. They are not expected to duplicate each other's position but both must demonstrate the qualities and application to influence strategy, day-to-day policy and their implementation, and both must actually do so in practice. Where there are more than two individuals directing the business, it is not necessary for all of these individuals to be involved in all decisions relating to the determination of strategy and general direction. But at least two individuals must be involved in all such decisions. Both persons' judgments must be engaged in order that major errors leading to difficulties for the investment provider are less likely to occur. Similarly, both persons must have sufficient experience and knowledge of the business and the necessary personal qualities to detect and resist any imprudence, dishonesty or other irregularities by the other person. Thus, where a single individual, whether a senior executive, or otherwise, is particularly dominant in an investment provider this will raise doubts about the fulfillment of the criterion.

2.4.c. Where investment business is carried out other than by a company or firm, paragraph 3 of Schedule 2 provides that the Authority may approve one individual to effectively direct a business. In reaching such a decision, the Authority is to have regard to the circumstances of the investment provider and to the nature and scale of its operations. The Authority believes that such a situation will be acceptable only when the business conducted is very limited in scope and scale. In particular, it is unlikely to be acceptable where the investment provider is entitled to hold clients' money. Where exceptional approval is given to one person directing an investment business, such approval will be kept under review and may be withdrawn e.g. because of growth in the underlying size or complexity of the business or because of the appearance of specific compliance or control problems which may arise.

2.5 Second Schedule Paragraph 4: “Composition of board of directors”

2.5.a. This paragraph provides that, in the case of a company, the directors include such number (if any) of non-executive directors, as the Authority considers appropriate. The number will depend on the circumstances of the investment provider and the nature and scale of its operations.

2.5.b. The Authority considers that non-executive directors can play a valuable role in bringing an outsider’s independent perspective to the running of the business and in ensuring proper challenge to the executive directors and other management. The Authority sees non-executive directors as having, in particular, an important role as members of an investment provider’s audit committee or in performing the role which such a committee would otherwise perform.

2.6 Second Schedule Paragraph 5(1): "Business to be conducted in a prudent manner"

2.6.a. Sub-paragraphs 1 and 9 make it clear that there is a general requirement for investment providers to conduct their business in a prudent manner.

2.6.b. Sub-paragraphs 2 to 8 set out a number of specific requirements in that regard, each of which must be fulfilled before an investment provider may be regarded as conducting its business in a prudent manner in terms of the paragraph.

2.6.c. However, the Act also makes it clear that the specific requirements outlined in sub-paragraphs 2 to 8 are not exhaustive. Accordingly the Authority takes into account a range of other considerations in assessing whether an investment provider is prudently run. These include for example, the licensee’s management and corporate governance arrangements (such as, in the case of a company, the composition of the board of directors and the arrangements for the board's overall control and direction of the entity); the investment provider’s general strategy and objectives; planning arrangements; policies on accounting, collections and bad debt; and recruitment arrangements and training to ensure that it has adequate numbers of experienced and skilled staff in order to carry out its various activities in a prudent manner. The Authority would also expect an investment provider to occupy premises suitable for the purpose of conducting its business. The Authority’s Codes of Conduct include additional guidance on what is expected in this area.

2.7 Second Schedule Paragraph 5(3): “Minimum net assets”

2.7.a. Investment providers are expected to monitor closely their net asset position. The Authority requires investment providers to maintain net assets of such a scale and in such a form as to safeguard the interests of clients and potential clients, having regard to:-

i) the risks inherent in the investment business;
ii) the risks inherent in any operations of related entities so far as they are capable of affecting the institution;
iii) any other factors which appear to the Authority to be relevant.

2.7.b. In the case of investment providers who carry on investment business as principal, minimum net assets of $250,000 are required. When investment providers carry on investment business as agent, the minimum level is $100,000; and where investment business is carried on otherwise than as principal or agent, net assets of at least $12,000 are required. In each case, the Authority maintains under review the adequacy of the stipulated minimum level, and may at any time substitute a higher figure when this is warranted by the nature of the particular business. In particular, a higher level of net assets is most commonly required where investment providers intend to take on material principal positions, for example through the trading or holding of significant portfolios of securities or derivatives. The same may also apply when, for example, substantive non-investment business is conducted within a licenced entity. Additional capital may also be sought where an investment provider intends to offer margin or other lending facilities. In all such cases, the Authority may, depending on the circumstances, either substitute a fixed higher net asset threshold or apply a fluctuating market-risk based capital requirement additional to the standard minimum net asset threshold.

2.7.c. In assessing the sufficiency of net assets, the Authority needs to have reasonable assurance that resources are genuinely available to support the investment provider’s business. The Authority will wish to be satisfied that claims on third parties are fully recoverable in the normal course of business. Moreover, all claims on other members of a group to which an investment provider belongs are normally deducted in calculating net assets, other than where the Authority has a separate regulatory responsibility for monitoring the capital adequacy of the connected entity or is in a position to assess capital adequacy for the wider group. In the same way, investments in subsidiaries and associates fall to be deducted in calculating net assets since they do not represent capital available to the investment provider. The same treatment applies to intangible assets such as goodwill.

2.7.d. In cases in which the Authority determines that a level of capital higher than the standard stipulated minimum net assets is required, some or all of the additional amount may take the form of supplementary capital as defined in the Authority’s paper “The Measurement of Capital” issued pursuant to the Banks and Deposit Companies Act 1999. Such supplementary capital must meet all the specific conditions and qualifications set out in the “The Measurement of Capital”, it is also restricted as to eligible amount relative to “core capital” in the way described in that paper.

2.7.e. In the case of partnerships, the Authority will normally have regard in assessing minimum net assets, to balances in partners' capital accounts net of any outstanding borrowing from the firm. For other unincorporated entities and for individuals, the Authority looks to satisfy itself in each case that the stipulated minimum net asset figure is, and will remain, freely available to support the investment business and to meet any losses that may be incurred.

2.8. Second Schedule Paragraph 5(4) and 5(5): "Adequate liquidity"

2.8.a. Investment providers are expected to monitor closely their liquidity position in order to ensure that they are always able to meet their obligations as they fall due. The Authority requires investment providers to maintain minimum liquidity which is equivalent at all times to at least 3 months' expenditure. However, when an investment provider does not act as principal or agent, a minimum 1 month's expenditure test applies. Expenditure is based on the latest annual (or annualised) financial statements, and is calculated as total revenue less profit before appropriations (or - in the case of an investment provider making a loss-plus loss before appropriations). Monthly expenditure is calculated by dividing annual expenditure by twelve.

2.8.b. Assets are considered to be liquid if they can be easily converted to cash within a reasonable period of time. The Authority may, to such extent as it thinks appropriate, take into account as liquid assets, in addition to assets of the investment provider, any facilities available to it which in the Authority's view are capable of providing liquidity within a reasonable period. The Authority would classify certain committed standby facilities, for example, as liquid assets.

2.8.c. The following assets will generally be considered liquid:

- Cash and cash equivalents (i.e. cash, term deposits, marketable securities);
- *Prepayments* where the period of prepayment is less than three months;
- Amounts accrued or receivable with respect to interest on marketable investments;
- Unsecured receivables if they are outstanding for less than 30 days;
- Receivables arising from sales of investments outstanding for less than 30 days from the contractual settlement date (if the debtor is outstanding for more than 30 days from the contractual settlement date, the amount should be written down to the lower of book value or market value);
- Other receivables arising from investment business outstanding for less than two months (i.e. amounts due from connected companies which are adequately secured and are repayable within 60 days, unsecured amounts due at the request of the company etc.);

The following assets are not considered liquid:

- All intangible assets; and
- Any other assets which are not listed above unless otherwise approved by the Authority.

2.9 Second Schedule Paragraph 5(6) and 5(7): "Adequate accounting and other records and adequate systems of control"

2.9.a. The Act requires an investment provider's records and systems to be such as to enable its business to be prudently managed and the investment provider to comply with the duties imposed on it by or under the Act or other provisions of law. In other words, the records and systems must be such that the investment provider is able to fulfill the various other elements of the prudent conduct criterion, and to identify threats to the interests of clients and potential clients. They should also be sufficient to enable the investment provider to comply with the notification and reporting requirements under the Act. Thus, delays in providing information, or inaccuracies in the information provided, will call into question the fulfillment of the requirement of sub-paragraphs 5(6) and 5(7).

2.9.b. The nature and scope of the particular records and systems to be maintained by an investment provider should be commensurate with its needs and particular circumstances, so that its business can be conducted without endangering its clients and potential clients. In judging whether an investment provider's records and systems are adequate, the Authority has regard to its size, to the nature of its business, to the manner in which the business is structured, organised and managed, and to the nature, volume and complexity of its transactions. The requirement applies to all aspects of an investment provider's business, whether on or off balance sheet and whether undertaken as principal or agent or in another capacity.

2.9.c The Authority requires investment providers to keep and maintain up-to-date accounting records in the English language which:

(a) in respect of the investment provider's business, disclose particulars of:
   - (i) assets held for the investment provider's own account;
   - (ii) liabilities incurred for the investment provider's own account; and
   - (iii) entries of income and expenditure made and an explanation of their nature; and

(b) in respect of the affairs of the clients of an investment provider, disclose particulars of:

(i) all assets held, managed or controlled by the investment provider for the account of clients, both individually respecting each client and collectively respecting all clients;
(ii) all liabilities incurred by the investment provider on behalf of clients, both individually respecting each client and collectively respecting all clients;
(iii) all transactions effected and carried out on behalf of clients, both individually respecting each client and collectively respecting all clients;
(iv) every document evidencing title to a client's asset held by the investment provider;
(v) where such document is held by a third party, particulars of such document and the name and address of that person; and
(vi) entries of the date on which every document evidencing title to a client's asset came into or left the possession or control of the investment provider.

2.9.d. For the purpose of paragraph 2.9.c. an investment provider may accept and rely on records kept by a third party where such records are capable of being reconciled with records kept by the investment provider.

2.9.e. The Authority requires investment providers to keep either at the principal office or registered office, or in such a manner that they can be produced to the Authority within such period as the Authority may specify, the following records for the following periods in respect of all investment business conducted by or through the investment provider:

(a) entry records, including account opening records, verification documentation and written introductions, for a period of at least five years from the date of the closing of the account.;
(b) account ledger records, for a period of five years from the date of the relevant transaction or series of transactions; and
(c) supporting records, including all records in support of ledger entries, credit and debit slips and cheques, for a period of five years from the date of the relevant transaction or series of transactions.

2.9.f. Any of the records required by paragraph 2.9 may be recorded and kept by an investment provider in electronic form or such other form as the investment provider thinks fit, provided that it is possible for the information to be inspected and for a copy of it to be produced in legible form. Information must be maintained in such a manner as to ensure that there is a clear and precise audit trail for every transaction.

2.10 Second Schedule Paragraph 5(8): " Adequate insurance"

Investment providers face a wide variety of potentially major financial risks in their business. Rather than requiring investment providers to hold capital against all these risks, the Act requires businesses to hold adequate insurance cover.

Relevant types of insurance include the following:

- errors and omissions/professional indemnity
- directors and officers liabilities
- fidelity and forgery
- loss of property
- computer crime
- computer damage
- business interruption
- office contents

In judging the adequacy of insurance cover, the Authority looks to be satisfied that the scope and scale of cover in place is such as to provide reasonable assurance of the ability of the investment provider to continue to trade in the event that it should face either major damage to its infrastructure or material claims from clients or third parties for loss and damage sustained. It is in the first instance for those directing the business to assess the level of risk they face in the business and to determine the extent of coverage appropriate for that business. The Authority will review the adequacy of cover in place, having regard to the scale, composition and complexity of the business and to the size of the deductible in relation to the investment provider's net asset position. However, in all cases, minimum insurance cover of $250,000 is required, and at least $500,000 where client assets are held. Higher amounts may be required having regard to the nature and scale of the business.

2.11 Second Schedule Paragraph 6 "Consolidated supervision"

This paragraph requires the Authority to be satisfied, in the case of investment providers which are members of wider groups or have ownership links with other entities, that the structures and relationships are not such as to obstruct the conduct of effective consolidated supervision. The Authority needs to ensure that any risks to an investment provider arising as a result of its membership of a wider group are fully taken into account. The objective, however, is to supervise the entity as part of its group, and not to supervise all companies in the group.

In order to conduct such monitoring and assessment, the Authority may need access to information relating to other parts of the group and to other connected entities. Where there are obstacles to transparency as a result of the particular structure adopted or the location of parts of the group, the Authority needs to satisfy itself that adequate information will be forthcoming and that the structure

and relationships are not such as to cause any other risks to the interests of the investment provider's clients and potential clients.

2.12 Second Schedule Paragraph 7 "Integrity and skill"

2.12.a. This paragraph is concerned with the manner in which the business of the investment provider is carried on and is distinct from the question of whether its controllers and officers are fit and proper persons. It covers whether the investment provider has sufficient personnel with professional skills appropriate to the nature and scale of the business concerned and with adequate knowledge, skill and experience necessary for the prudent management and conduct of the business.

2.12.b. The integrity element of the criterion requires the investment provider to observe high ethical standards in carrying on its business. Criminal offences or other breaches of statute will obviously call into question the fulfilment of this criterion. Particularly relevant are contraventions of any provision made by or under enactments, whether in Bermuda or elsewhere, designed to protect members of the public against financial loss due to dishonesty, incompetence or malpractice. Doubts may also be raised if the investment provider fails to comply with recognized ethical standards such as those embodied in various codes of conduct. The Authority has regard to the seriousness of the breach of the codes, to whether the breach was deliberate or an unintentional and unusual occurrence, and to its relevance to the fulfilment of the criteria in the Second Schedule and otherwise to the interests of clients and potential clients.

2.12.c. Professional skills cover the general skills which the investment provider should have in conducting its business, for example, in relation to fiduciary responsibilities, establishing and operating systems of internal controls, ensuring compliance with legal and supervisory requirements, and in the standard of the various financial services provided. The level of skills required will vary according to the individual case, depending on the nature and scale of the particular investment provider's activities.

2.12.d. The Authority would expect investment providers to have a number of employees sufficient to carry out the range and scale of the business. The Authority, in determining whether there are sufficient personnel, will take into account the human resources that the investment provider may draw on through other arrangements, e.g. outsourcing, secondments, or other similar arrangements.

PART 3 Principles Relating to the Granting of Licences

3.1 To grant a licence under the Act, the Authority needs to be satisfied that all the minimum licensing criteria in the Second Schedule are met. In order to be so satisfied, the applicant and any other relevant parties must first have provided all

the appropriate information requested by the Authority in connection with the application. Even where it is satisfied that the criteria are or can be met, the Authority retains a residual discretion not to grant a licence - notably if it sees reason to doubt that the criteria will be met on a continuing basis or if it considers that for any reason there might be significant threats to the interests of clients or potential clients. The Authority also considers, in exercising its discretion, whether it is likely that it will receive adequate information from the investment provider and relevant connected parties in order to enable it to monitor the fulfillment of the criteria and to identify potential threats to the clients.

PART 4 - Grounds for Revocation of a Licence

4.1 Section 21 of the Act sets out the Authority's powers to revoke a licence. This Part gives guidance on the Authority’s interpretation of the grounds in section 21 of the Act.

4.2 The grounds upon which the Authority may take action are widely drawn, enabling the Authority to exercise its powers before a threat to clients may become very great or immediate. As a result, the Authority is able to act, where necessary, before the deterioration in an investment provider’s condition is such that there is a serious likelihood that clients will suffer damage. When its powers become so exercisable, the Act gives the Authority wide discretion in determining the action it feels appropriate to safeguard the interests of clients. In particular, it may revoke the licence, apply restrictions to a licence or impose disciplinary measures under Chapter 6 of the Act. The Principles relating to the Authority's exercise of this discretion are described in Part 5.

4.3 Section 21(a) provides that the Authority’s powers become exercisable if it appears that any of the criteria in the Second Schedule is not or has not been or may not be or may not have been fulfilled. The Authority would consider that a criterion 'may not be fulfilled' in circumstances where the evidence available raised a material doubt about whether a criterion is or has been fulfilled.

4.4 Under section 21(b) the Authority’s powers become exercisable if the investment provider fails to comply with any obligation imposed by or under the Act (for example, the obligation to provide a certificate of compliance to the Authority pursuant to section 44). Similarly, it covers any failure to comply with requirements imposed by the Authority using its formal powers under the Act (for example a restriction under section 20 or a requirement to provide information under section 45).

4.5 Under section 21(c) the Authority’s powers are also exercisable in circumstances in which a shareholder acquires an interest of 50% or more in the investment provider without having received the Authority’s prior non-objection, or retains such an interest despite having been served with a notice of objection.

4.6 Section 21(d) provides that the Authority's powers also become exercisable if it is provided with false, misleading or inaccurate information by or on behalf of the investment provider or in connection with an application for a licence by or on behalf of a person who is or is to be an officer or controller. The simple provision of inaccurate information renders the power exercisable. However, in practice, the Authority would not consider exercising its powers under this section unless the inaccuracy was material, or symptomatic of wider prudential concerns.

4.7 Finally, section 21(e) provides for the power to be exercisable when the interests of the clients or potential clients are threatened in any way. Although breaches of the licensing criteria and other matters referred to above cover most of the circumstances which would pose a threat to the interests of clients and potential clients, other sudden external threats unconnected with the investment provider's conduct remain possible – for example as a result of a natural catastrophe or force majeure declaration. This paragraph ensures that the Authority is enabled to act where the interests of clients or potential clients are threatened in any other way, whether by the manner in which the investment provider is conducting or proposing to conduct its affairs or for any other reason.

PART 5 - Principles Relating to Restriction or Revocation of a Licence

5.1 Where its powers of formal intervention are exercisable, the Authority seeks, in deciding on the appropriate course of action, to act in the interests of the investment provider's existing and potential clients. As noted above, the Authority's formal intervention powers become exercisable in a wide range of circumstances and a range of alternative courses of formal action are open to the Authority. Where the Authority can have adequate confidence in an investment provider and its management, it is always open to it to seek remedial action by informal means, notably through persuasion and agreement with the investment provider regarding the steps to be taken to return it to compliance. Wherever possible, the Authority seeks to proceed in this manner. Where the Authority can be satisfied that prompt and adequate remedial action will be put into effect, thereby protecting the interests of clients and potential clients, it is generally reluctant to revoke or restrict the licence. However, where the prudential concerns are very serious or where the Authority feels less able to rely on a purely informal approach, it is likely that formal action will be taken.

5.2 Where there are serious concerns and there is no reasonable prospect of speedy and comprehensive remedial action, the Authority is likely to consider revocation, even if the threat to clients is not seen as immediate. On the other hand, where formal supervisory intervention holds out good prospects of achieving successful remedial action within an acceptable time-scale, the Authority will not normally wish to revoke a licence. In so far as is consistent with the interests of clients, the Authority will always seek to explore fully the prospects of remedial action.

5.3 Section 22 of the Act provides that where the Authority concludes that its powers are exercisable and should be exercised, it must first serve notice of its intention to act. An investment provider then has a period within which it can make representations, which the Authority needs to consider before issuing a final notice regarding the action to be taken. Where the investment provider remains aggrieved by the Authority's decision, it then has certain rights of appeal.

5.4 The circumstances in which a restricted licence rather than revocation is likely to be appropriate are where the Authority considers that the imposition of restrictions may provide effective underpinning to an investment provider's efforts to remedy the situation, and that there is a reasonable prospect that all the relevant criteria will be fulfilled again within a reasonable period. The Authority, therefore, looks for a sound and viable programme of swift remedial action.

5.5 On occasion, however, when concerns arise it may also be desirable to impose restrictions as a holding measure to protect clients and potential clients while further information is sought and evaluated.

5.6 Section 23 of the Act provides for the Authority to impose or vary restrictions with immediate effect (i.e. without serving notice of its intention to act) when it considers it a matter of urgency. Wherever possible, the Authority adheres to the normal notice provisions set out in section 22. However, where it perceives or suspects a serious immediate concern to the interests of clients or potential clients, it considers the need for urgent action. This may also involve circumstances in which it sees it as important for holding action (e.g. to prevent further deterioration of the position) to be taken while fuller information is sought.

5.7 In all cases in which the Authority concludes that its powers to restrict or to revoke a licence are exercisable it will also consider whether to publish a statement of public censure of an investment provider. Such a statement may be pursued even where the Authority may ultimately opt not to take formal action to revoke or restrict a licence.

PART 6 - Power to Obtain Information and Reports

6.1 Supervision involves the receipt and analysis of a variety of regular and ad hoc financial and other information from investment providers. The Authority's standard reporting arrangements are kept under review, agreed with investment providers from time to time and amended in the light of developments. Such reports and information are routinely provided by investment providers on an entirely voluntary basis.

6.2 Certain matters are, however, the subject of specific statutory reporting requirements – notably, for example, the requirement for an investment provider to submit a certificate of compliance, signed by an officer, certifying that the licensee has complied during the year with the minimum criteria and any limitations imposed on the licence.

6.3 Section 45 of the Act provides formal powers for the Authority by notice in writing to require from an investment provider such information as it may reasonably require for the performance of its functions under the Act. The section also provides for the Authority to require a licensee to provide it with a report by its auditor or by an accountant or other person with relevant professional skill on, or on any aspect of, any matter about which the Authority has required or could require the investment provider to provide information under the section.

6.4 Formal use of the power requiring an investment provider to provide the Authority with such information is most infrequent since the Authority is able generally to rely on the willingness of licensees to provide information voluntarily. In particular circumstances, however, the Authority must consider whether to make use of this power – notably, for example, where it has material concerns about the accuracy or completeness of information provided by an investment business.

6.5 Similarly, the Authority needs to consider when to make use of its power to commission reports from an auditor or other relevant professional. The Authority has agreed that any such reports will in normal circumstances be commissioned from an investment provider's own external auditors. However, in certain circumstances, another professional firm may be used. This would be the case, for example, where a report called for particular technical skills or when the Authority had had previous concerns about the quality or completeness of work conducted by the external auditor.

6.6 The Authority has also agreed that, as a general rule, it will limit the extent to which it will have recourse to professional reports of this nature. Instead, as a matter of general policy, it uses its own staff to assess directly through on-site work the adequacy of investment providers' systems and controls. However, where particularly specialized work is required or other considerations arise, the Authority may have recourse to commissioning a professional report. In addition, the Authority may from time to time commission auditors' reports with a view to obtaining verification of prudential data submitted by investment providers, in order to provide assurance to the Authority of the accuracy and completeness of financial reporting.

6.7 Section 46 of the Act provides statutory powers for the Authority by notice in writing to require an investment provider to produce relevant documents or information. This power can also be used to obtain relevant documents in the possession of other persons; and also to require information or documents from

entities related to an investment provider. Section 47 of the Act provides the Authority with specific powers to enter the business premises of such persons for the purpose of obtaining relevant information or documents. Use of these powers is exceptional, and generally reflects circumstances in which the Authority has serious concerns about the operations of an investment provider or of companies with which it is linked.