



ISLE OF MAN FINANCIAL SERVICES AUTHORITY

Supervisory **Methodology** Framework

JANUARY 2025

Contents

Foreword by the CEO	page 3
Introduction.....	page 4
Our supervisory structure	page 6
Risk-based supervision	page 7
Our risk universe	page 9
How we assess risk.....	page 10
Supervisory activity	page 11
Our powers and supervisory toolkit.....	page 16
Governance	page 17
Inherent risk and control considerations.....	pages 18-21

Foreword by the CEO

The Isle of Man Financial Services Authority plays a key role in maintaining the Island's reputation as a leading international business centre.

The integrity of the regulatory system helps to support the Island's economy and environment for financial services and contributes towards the effectiveness of firms competing in the global marketplace.

The Authority's strategic priorities, which we review every three years, are also closely aligned with the Isle of Man Government's vision to build a secure, vibrant and sustainable Manx economy.

As a modern regulator, we focus on the risks that pose the greatest threat to our objectives of protecting consumers, reducing financial crime, and maintaining confidence in the Island's financial services sector.

This document sets out the culmination of our long-standing plans to embed a revised internal structure to support the implementation of an updated supervisory methodology framework.

Our supervisory approach will be more proportionate to a firm's impact

'The transition will ensure our time, skills and experience are deployed in the most appropriate and efficient way'

as determined by its size, the type of activities it conducts, and its potential to cause disruption to the Island's financial system. In parallel, our AML/CFT supervisory approach will be more proportionate to the level of money laundering or terrorist financing risk to which a firm is exposed.

The transition from a predominantly sector risk-based approach to a wider impact and risk-led model will make sure our time, skills and experience are deployed in the most appropriate and efficient way.

It will also underpin efforts to future-proof the delivery of our regulatory services in order to remain effective, responsive and in-tune with the needs of a dynamic industry.

Please take the time to read this document, and do not hesitate to contact us if you wish to talk to us about any of the contents.

Bettina Roth,
Chief Executive Officer



Introduction

The Authority is the regulatory body for the financial sector in the Isle of Man and regulates firms engaged in a range of financial activities.

It is also responsible for oversight of anti-money laundering and countering the financing of terrorism (AML/CFT) compliance for those involved in the financial sector and a range of other designated businesses, together with oversight of compliance with the Beneficial Ownership Act 2017.

The Authority's work is driven by its three main regulatory objectives:

- Protecting consumers
- Reducing financial crime
- Maintaining confidence in the financial services sector through effective regulation

A key part of delivering these objectives is through effective supervision and oversight of regulated firms, designated businesses (together, "firms"), and specified individuals. We operate an approach whereby we focus our finite resources on firms and activities that pose the greatest potential impact and/or risk to our objectives, through four dedicated supervisory divisions that work closely together.

This document, the "Supervisory Methodology Framework", sets out how we carry out our role in practice, noting that firms are responsible for managing the risks within their business according to the boundaries of the regulatory frameworks.

It is designed to help firms and the wider marketplace understand how we supervise, and to aid accountability.

The Supervisory Methodology Framework enables us to:

- Better understand the business of, and risks posed to and by, firms
- Wherever possible collaborate with firms and follow a reasonable path to achieve the right outcomes
- Utilise a structured engagement model, which also aids accountability
- Focus our engagement on higher impact firms
- Achieve economies of scale through thematic reviews (including inspections) with low impact/lower risk firms
- Publish observations of good and poor practice
- Promote consistency in supervisory judgement
- Assess and respond to risk in a consistent and structured manner
- Use governance mechanisms to ensure consistency, and to challenge and refine our Supervisory Methodology Framework

Regulated firms

The Supervisory Methodology Framework means that the highest impact firms (those firms with the greatest capacity to cause significant disruption to the Isle of Man financial system and wider local economy) will receive the most attention under our engagement model. We have a lower risk appetite for significant issues that may arise at firms rated as high and medium impact, and aim through our supervision to develop a robust and comprehensive view of these firms. This enables us to better judge whether they are being run in a safe manner and are providing appropriate protection for their consumers.

Conversely, we take a different approach to supervising smaller (low impact) firms. Individually, these firms have little or no capacity to cause disruption to the financial system and wider local economy, but in the event of sector-wide issues could pose significant risk. Our approach to supervising these firms therefore includes:

- the use of data automation and exception reporting utilising risk indicators to target supervisory engagement (whether at firm or sector level)
- examining individual firms when a risk crystallises (for example through a notification from the firm)
- conducting peer group analysis (which may include thematic based work) across sectors to develop a clear understanding of the risks

‘We have a lower risk appetite for significant issues that may arise at firms rated as high and medium impact’



All firms (regulated firms and designated businesses) – AML/CFT supervision

For AML/CFT, our Supervisory Methodology Framework is designed so the firms and sectors that pose the highest level of money laundering or terrorist financing risk receive the most attention under our engagement model, whilst for lower risk firms there will be a greater emphasis on thematic work and outreach. A key part of our approach to assessing risk at firm and sector level is through data automation.

1. Our supervisory structure

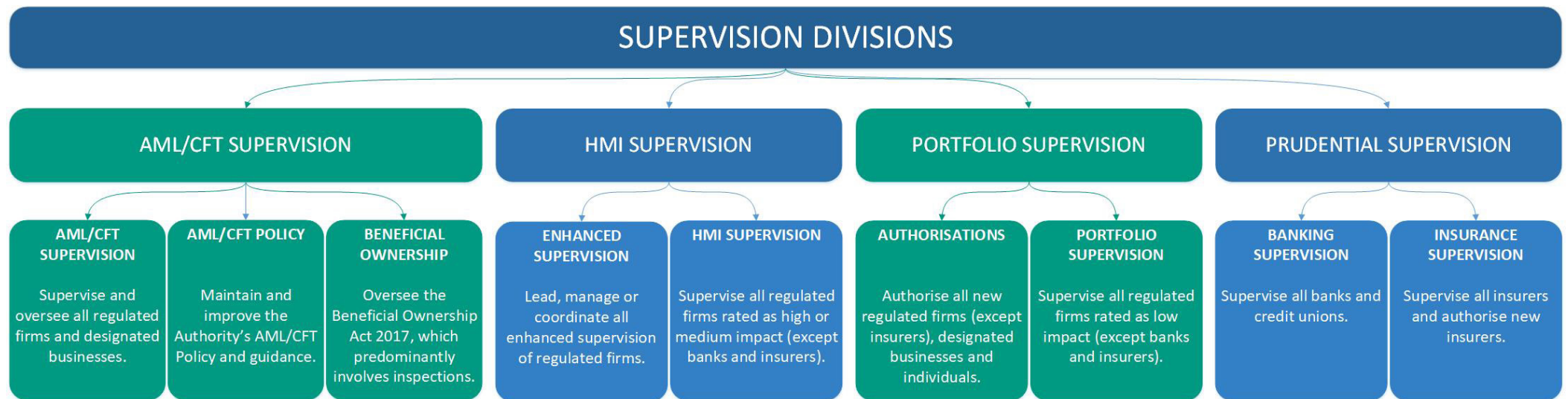
The Authority operates through four dedicated supervisory divisions. One division focuses solely on the AML/CFT supervisory oversight of all firms and sectors, with the other three divisions covering all other supervision and authorisation activity.

This divisional structure helps us to:

- Achieve greater synergies and efficiencies within our workforce and support the Supervisory Methodology Framework

- Facilitate cross training, improving our ability to respond swiftly to change and build our resilience
- Improve consistency in how we supervise
- Ultimately, be more effective in delivering our regulatory objectives

Further information about the supervisory divisions is available on our website at [“Supervisory Divisions”](#).



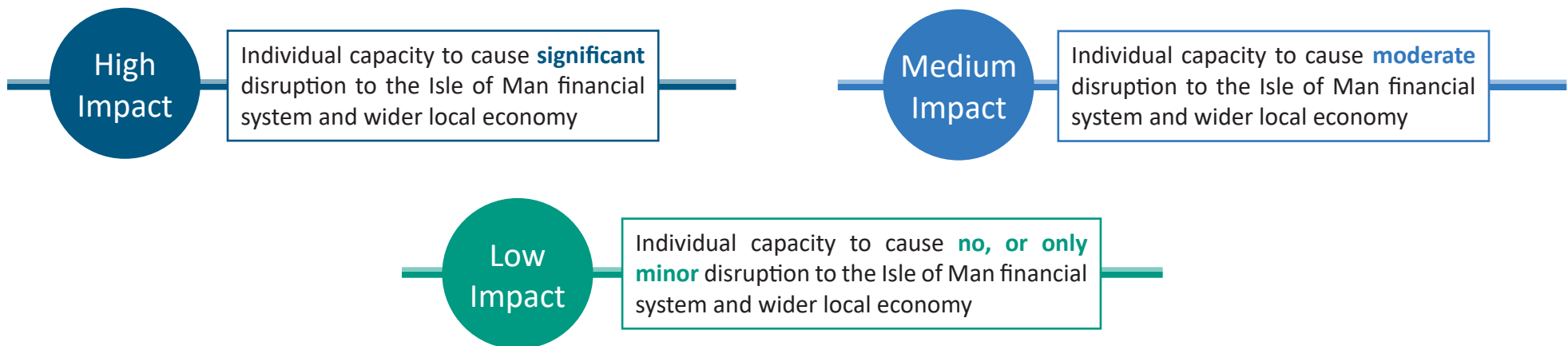
2. Risk-based supervision: impact and risk

Regulated firms

Impact is a cornerstone of the Authority's risk-based Supervisory Methodology Framework for all non-AML/CFT supervision. For each firm, we assess and judge its "impact" as the degree of disruption that would be caused to its consumers, and to the financial system, the economy and the reputation of the Isle of Man were it to fail, or carry on its business in an unsafe manner.

In general, the higher the impact rating is for a firm, the more intensely it is supervised. Risk-based supervision means that we have a lower appetite for significant issues that may arise at high impact firms, relative to issues in those deemed low impact. This principle guides us to prioritise structured engagement and deploy our supervisory resources appropriately.

The impact ratings we use are:



Risk-based supervision: regulated firms

We undertake impact assessments on a cyclical basis. When judging and assessing impact, we take into consideration quantitative and qualitative factors, such as the size, nature and complexity of business for each firm using a three-stage approach:

- 1 A quantitative assessment using data collected from statistical returns provided by firms
- 2 A qualitative overlay taking into account the nature and complexity of the firms is applied
- 3 Finally, an internal Impact Rating Panel reviews, moderates and agrees the ratings

The impact rating of each firm determines the supervisory activity and engagement model that applies, and which of the three non AML/CFT supervisory divisions is responsible for the delivery (see section 3). Firms are told their impact rating and, where necessary, of any changes to their supervisory contacts at the Authority.

Impact ratings are a matter of supervisory judgement, taking into account a wide range of relevant factors, and are not subject to appeal.

Impact ratings for newly regulated firms are calculated using the information provided within the licence application and reviewed by the Impact Rating Panel.

When a significant trigger event occurs, such as acquisitions and mergers, the Impact Rating Panel may re-convene to re-assess that firm's impact rating mid cycle.

Understanding the capacity for a firm to cause disruption (and thus potential to cause harm to consumers) is a critical component of the Supervisory Methodology Framework; risk-based supervision does not (and should not aim to) eliminate all risk. It does however provide a systematic and analytical way of identifying and addressing risk.

Robust prioritisation, taking into account impact, means that some sources of risk will be accepted, as it is imperative that we focus our resources on the risks that are most significant to our regulatory objectives. Fundamentally, this means that a deeper analysis of risk is undertaken for the high and medium impact firms, when compared to the low impact firms.

All firms (regulated firms and designated businesses) – AML/CFT supervision

For AML/CFT supervision, our focus is on those firms and sectors that pose the highest level of money laundering or terrorist financing risk (referred to in our framework as “financial crime risk”). Our supervisory activity and engagement model (see section 3) is driven primarily by an assessment of financial crime risk, noting that the size of a firm or sector will have some bearing on these assessments.

Our risk universe

When assessing the risk a firm poses to our regulatory objectives, we consider seven risk categories as specified in the chart below. This involves, for each category, assessing both the inherent risk and, where applicable, the controls (to determine residual risk). The AML/CFT supervision division assesses financial crime risk for all firms, whereas the other supervisory divisions undertake an assessment of the other six risk categories at firm and/or sector level from the perspective of consumer protection – the depth of those risk assessments takes into account the impact rating of a firm/sector.

The definitions for each risk category within the risk universe, accompanied with the topics considered when assessing inherent risk and controls are shown in the appendices.



Assessing risk at firm level

We assess risk at firm level, using our supervisory tools, data from returns, intelligence gathered, findings from thematic work and inspections, and considering the external environment.

We do not take relevant information into a formulaic approach for each risk category; rather, our staff also use supervisory judgement when assessing risk, with a focus on identifying risks outside of our tolerance so we can take proportionate supervisory action under our engagement model (see section 3).

How we assess risk

We assess risk (inherent and residual) on a scale of low, medium, medium high, or high, in accordance with the following definitions:

Inherent risk

In the absence of the risk being controlled and managed, or urgent/significant remediation, the probability of harm or loss to consumers or ML/TF threat occurring is considered to be **very likely**.

Residual risk (after controls)

There is an **imminent risk** of significant harm or loss to consumers or ML/TF threat occurring without critical and immediate corrective action being taken.

Inherent risk

In the absence of the risk being controlled and managed, or minor remediation, the probability of harm or loss to consumers or ML/TF threat occurring is considered to be **small or unlikely**.

Residual risk (after controls)

There is a **low to moderate** risk of significant harm or loss to consumers or ML/TF threat occurring.

Inherent risk

In the absence of the risk being controlled and managed, or remediation, the probability of harm or loss to consumers or ML/TF threat occurring is considered to be **quite likely**.

Residual risk (after controls)

There is a **risk** of significant harm or loss to consumers or ML/TF threat occurring without corrective action being taken.

Inherent risk

Even in the absence of the risk being controlled and managed, the probability of harm or loss to consumers or ML/TF threat arising is considered to be **very unlikely**.

Residual risk (after controls)

There is **minimal** risk of significant harm or loss to consumers or ML/TF threat occurring.



3. Supervisory activity: engagement model and regulatory tools

We engage with firms to understand their business models and the risks they pose. This allows us to prioritise our work, focus on relevant regulatory matters and take proportionate action. We operate engagement models that provide our supervisory teams with a structured framework, setting out the expected engagement with firms corresponding to impact and/or risk.

We broadly operate two engagement models, one which is driven from a firm's impact rating (regulated firms only), and one which is only in relation to AML/CFT supervision. Both engagement models consist of a variety of supervisory activities described below, together with the use of our supervisory toolkit.

Regulated firms (impact-led engagement model)

Firms rated as high and medium impact undergo a robust and proactive programme of supervisory engagement to ensure we continue to have a thorough understanding of the risks posed by those firms. This enables us to better judge whether they are being run in a safe manner and are providing appropriate protection for their consumers.

In contrast, the programme of supervisory engagement differs for firms rated as low impact, with greater use of automation and exception reporting being a key component to identifying risks, alongside sector-based risk views.

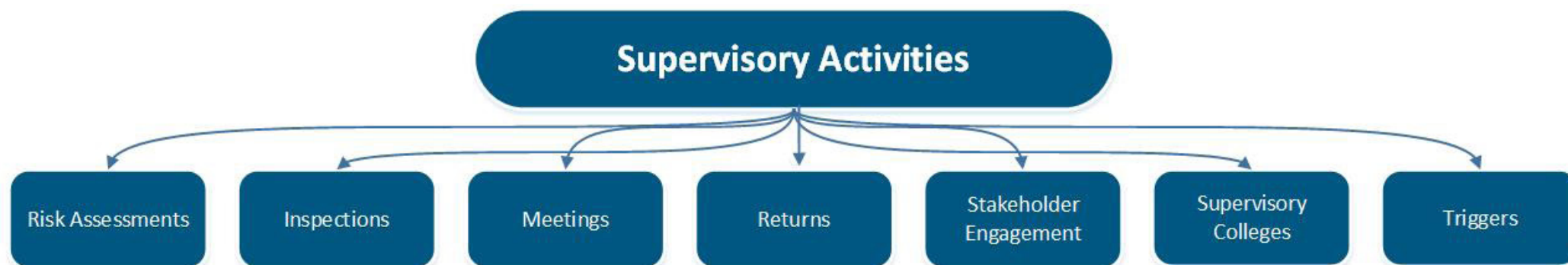
This enables us to conduct a programme of targeted proactive supervision, identifying and reacting to areas of potential risk to achieve significant economies of scale, for example thematic reviews (using questionnaires and/or thematic inspections) to efficiently assess a specific risk area across a cohort of firms and publishing messages out to all firms.

All firms (regulated firms and designated businesses – AML/CFT supervisory engagement model)

Firms should note that the AML/CFT supervisory engagement model is separate and distinct from the supervisory impact led engagement model; rather than being driven by impact, engagement is driven by a firm's financial crime risk rating. This is because the reduction of financial crime is a primary objective of the Authority; therefore we will focus AML/CFT Supervision resources on firms assessed as high and medium-high financial crime risk. This means that higher intensity supervisory engagement is used to monitor firms that are higher risk. Other less intensive supervisory measures such as AML/CFT Thematic Questionnaires and outreach activities (e.g. presentations and seminars) are also used as part of the AML/CFT supervisory programme across the whole cohort of firms.

Our supervisory activities

Our engagement models include a range of supervisory activities, the key components of which are set out and explained below. When conducting our supervisory activities we also take into account where there is more than one firm within the same corporate group, and how integrated the systems, business models, controls and governance is for firms within those groups.



Risk Assessments

Using information we collect through our supervisory activities, and our wider understanding of the external environment, we perform risk assessments and analyses to identify risks, which if they crystallise, may pose the greatest threat to our regulatory objectives of protecting consumers, reducing financial crime, and maintaining confidence in the Island's financial services sector.

Firms (regulated firms and designated businesses) - financial crime risk assessments

We undertake financial crime risk assessments for all firms, using information submitted by firms annually. These assessments provide a base-line view of financial crime risk (inherent and residual) at both firm and sector level, and help to drive where we should focus our attention.

In addition, we consider the external environment more widely when developing our risk view and supervisory engagement.

Regulated firms

For high and medium impact firms, we consider and document an assessment of inherent risks across six risk categories (see section 2). We also document our assessment of the control environment relevant to those risks, with a deeper focus on areas of higher inherent risk.

We review and update the risk assessments on a periodic basis, more frequently for high impact firms.

For low impact firms, we assess risk on a targeted basis, focusing our attention on specific risks as they arise. We complement this approach by also considering, where applicable, sector risks with reference to the six categories; this enables us to take a forward-looking approach when, for example, considering thematic work across the population.

Inspections

Inspections (which includes thematic work) are a crucial element of our engagement model to improve our understanding of the risks firms face and their control environments, to review or address specific risk areas that may be causing us concern, or confirm compliance with our regulatory requirements.

We undertake two broad types of inspection:

Firm specific inspections – conducted in response to a known or perceived risk within a firm, or to help test compliance with regulatory requirements.

Thematic – conducted in response to a known or perceived risk at industry or sector level and may be conducted by way of questionnaire or on-site inspection, or a combination of both. We may also conduct thematic work to help us better understand specific risk areas as part of undertaking firm risk assessments.

For AML/CFT supervision, we target more of our thematic review and inspection work based on areas of high and medium high risk (firm and sectors).

For more information on inspections, see the Guidance on Inspections for firms.

Firms should view inspections as an opportunity to demonstrate their compliance or to identify areas for improvement, with both the Authority and firms being open and co-operative to achieve the right outcomes.

‘Firms should view inspections as an opportunity to demonstrate compliance or to identify areas for improvement’

Meetings

We use meetings with firms to better understand firms' risks and issues (including from a wider industry perspective), to discuss areas of concern, and achieve a collaborative approach. We will meet more frequently (and on a proactive basis) with those firms assessed as high and medium impact. We will also hold meetings with firms to focus on specific issues, concerns, or to discuss complex matters. For AML/CFT supervision, we may hold specific meetings with firms' risk and compliance functions or money laundering reporting officers (MLROs). The types of firm stakeholders that we may request to meet include:

- Executives and/or Senior Management
- Independent Non-Executive Directors and Other Non-Executive Directors
- Risk and Compliance function(s)
- Actuarial Functions (insurance only)
- Chief Financial Officers/Finance function(s)
- Internal Audit (where relevant)
- External Auditors
- MLROs

To facilitate effective outcomes from meetings:

- Where we instigate a meeting, we will provide an agenda and often request information in advance.
- Where a firm seeks a meeting, we expect it to provide an agenda and supporting reasons for the meeting. Sometimes, we may request information in writing before agreeing that a meeting is required.
- They should be open and constructive.

Returns

The collection of data within returns submitted by firms is critical to the Supervisory Methodology Framework, as this provides risk indicators at firm level, and enables trend and peer group analysis to help us better understand the firms and sectors we regulate or supervise.

See the returns page of our website relevant to each sector for more information:

- [Firms regulated under the Insurance Act 2008](#) (except General Insurance Intermediaries)
- [General Insurance Intermediaries](#)
- [Firms regulated under the Financial Services Act 2008](#) (except Class 9 licence-holders)

Banks and insurers are also required to submit additional prudential information, including ICAAPs and Recovery Plans (banks), and ORSAs (insurers). These firms are also subject to more detailed, industry specific solvency (capital) and liquidity requirements.

‘We will meet more frequently, and on a proactive basis, with those firms assessed as high and medium impact’

Stakeholder engagement

An open and cooperative relationship between the Authority and the firms it oversees and regulates is crucial to effective supervision. We seek to understand the business of, and risks posed by, firms whilst having in place effective and proportionate regulatory frameworks. We have in place the following channels of communication to achieve this:

- Firms contact us through their designated point of contact, be that an individual or a team;
- The returns that firms submit are used to better understand firms' risks;
- We engage with firms based on specified engagement models (impact and/or risk led), using thematic reviews, inspections and meetings;
- We use meetings with industry bodies, workshops, conferences and seminars as a mechanism to engage with firms and sectors;
- We issue guidance, thematic reports and 'Dear CEO' letters, for firms to consider and use to improve their risk and control environments;
- We issue public warnings and notices, for firms to learn from;
- We use our website and social media pages to share information; and
- We learn and improve from industry surveys.

It is important to highlight that where risks arise, we welcome early dialogue so that we understand emerging risks and new opportunities.

Supervisory colleges

The Authority is an active participant in supervisory colleges, which are an important component of our supervisory activities. They help us to share information with other regulators about financial services groups with a presence on the Island (typically high and medium impact firms, most notably in respect of banks and certain insurers), improve our understanding of risk, and learn about market and regulatory developments.

We may organise and chair a supervisory college, where we are the home supervisor, or as other circumstances may apply (for example for larger fiduciary groups, or for insurance groups if we are the "group supervisor"), or we may be invited, as a host supervisor, to attend a college arranged by an overseas home regulatory supervisor.

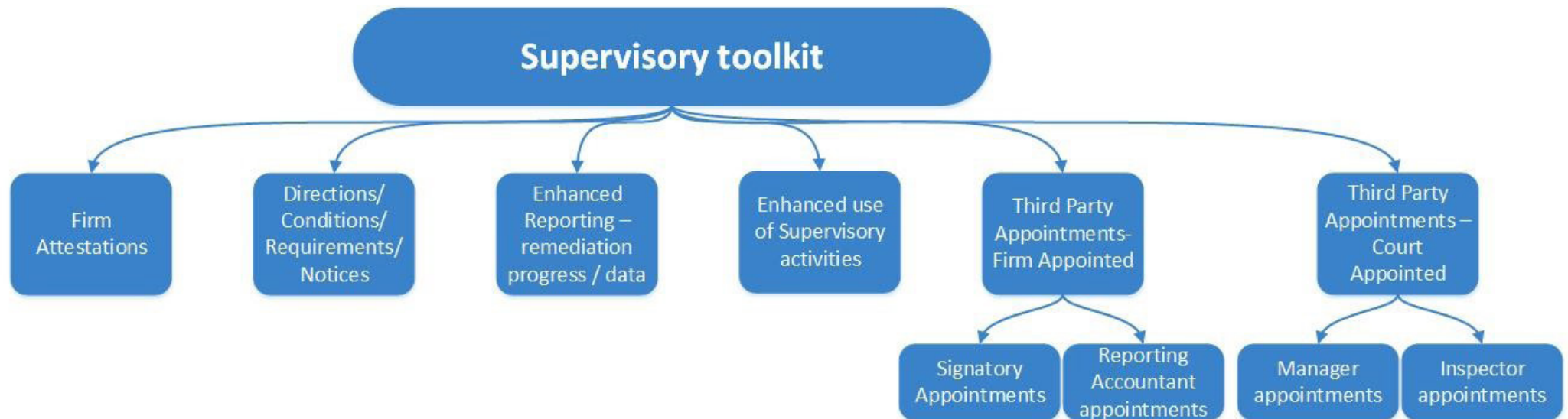
Triggers

When triggers arise, we evaluate the risk and may take proportionate supervisory action, noting that it is a firm's responsibility to manage risk appropriately. Triggers may include, but are not limited to:

- Notifications made by firms;
- Breaches reported, or identified;
- Customer complaints;
- Information gateways with other agencies and authorities;
- Material external events;
- Intelligence gathering; and
- Whistleblowing.

Our powers and supervisory toolkit

We have a variety of formal powers available to us under the legislative framework that we operate within and, during the course of our supervision, we may deem it necessary to exercise these powers in a formal way, to reduce risks. We may also intervene at an early, justified stage, to help prevent unacceptable risks crystallising. Our supervisory toolkit as illustrated below provides examples of where we exercise our formal powers, and tools where we work in collaboration with firms:



Our general principle is that we seek to understand, collaborate and follow a reasonable path of remediation to achieve the right outcomes. While all supervision divisions utilise the supervisory toolkit to manage risk (typically enhanced reporting and enhanced use of our supervisory activities), where the matter is deemed significant, it would be referred to, and taken on by, the enhanced supervision team. Where this is the case, a firm is notified that the matter has been referred.

In addition to utilising our supervisory toolkit, where we have material concerns, the matter will be considered for referral to Enforcement (and may lead to the use of other regulatory powers against firms or individuals).

Enforcement is pursued where proportionate, reasonable and appropriate, and may be in parallel with remediation. See the [Enforcement page](#) for more information.

4. Governance

A healthy culture of challenge is essential for effective and consistent supervision; in order to achieve this the Authority has established Governance Panels (“Panels”). We operate four types of panels, all of which have a purpose of facilitating cross-divisional challenge and driving consistency of approach to supervision, supporting the Executive in satisfying itself that we are exercising our judgements in a fair, proportionate and consistent manner. The specific purpose of each panel is to:

- Provide challenge in respect of appropriate usage of the supervisory toolkit on matters of material concern, the possibility and appropriateness of remediation, and, reach consensus in respect of referral recommendations (whether to escalate to enhanced supervision and/or Enforcement);
- Review and agree proposed impact ratings;
- Review and challenge the robustness and adequacy of firm risk assessments and, where applicable, risk mitigation programmes; and
- Identify and scrutinise processes that require consistency improvements.

‘Governance Panels will help to achieve a healthy culture of challenge to drive effective and consistent supervision’



Appendices: Risk Categories

Conduct Risk

In a supervisory context, conduct is the principles, standards and the manner in which the firm (including its employees and any other party representing the firm) behaves, organises themselves and carries out any activity.

Conduct risk is the risk that the firm's and its employees' behaviour may result in poor customer outcomes, unfair treatment of customers, or has a detrimental impact on the Island or effective competition. This may arise due to factors such as the firm's culture, the development/marketing of unsuitable products, lack of transparency around product features, or failure to treat customers fairly.

Inherent risk considerations

Customer Types

Products / Services

Delivery

External Factors

Control considerations

Board and Senior
Management Oversight

Policies and
Procedures

Internal Controls
and Audit

Risk Monitoring and
Management Systems

Clients' Assets Risk

The risk that a firm is holding monies and/or assets on behalf of clients and does not protect them appropriately, such that the client loses those monies and/or assets. This may occur due to:

>> Theft and/or misuse of Clients' Assets;

>> An operational control failure (whether inadvertent or deliberate/negligent or poor administration); or

>> The insolvency of the firm if Clients' Assets are not properly segregated and creditors try to seize these assets to settle the firm's debts.

In addition, it is critical to consumer protection and confidence that firms are able to return Clients' Assets promptly and without undue delay in the event of failure.

Inherent risk considerations

Account Types

Asset Types

Transactional Profile

Outsourcing
Arrangements

Counterparties /
Third Party Providers

Control considerations

Board and Senior
Management Oversight

Policies and
Procedures

Internal Controls
and Audit

Risk Monitoring and
Management Systems

Financial Crime Risk

The risk that a firm is exposed to (implicated in, or facilitating) financial crimes such as:

- >> Money laundering (ML)
- >> Bribery and corruption
- >> Market abuse and insider trading
- >> Terrorist financing (TF) and proliferation
- >> Tax evasion
- >> Fraud

The Isle of Man can be vulnerable to financial crime through the products and services offered by the financial and professional services sectors, particularly to an international client base. Should a financial crime risk crystallise, it could have a detrimental impact on the reputation of the Isle of Man and the applicable firm(s). For the purpose of this risk category, reference to 'financial crime risk' is mainly focused on ML and TF risks, and the AML/CFT controls to mitigate those risks.

Inherent risk considerations

Customer Types

Products / Services

Delivery

Geographic Scope

Control considerations

Board and Senior Management Oversight

Policies and Procedures

Internal Controls and Audit

Risk Monitoring and Management Systems

Governance Risk

The risk that a firm has ineffective risk management systems, internal control functions and/or governance, for example a Board that does not exercise appropriate direction and oversight.

The culture of a firm is inextricably linked to its Governance Risks and the effectiveness of the governance and control environment. Poor culture poses numerous and significant risks, including unacceptable risk taking and non-compliance with relevant agreements, laws and regulation. Indicators of poor culture may include, but are not limited to, dominant controller(s), poor risk management quality/poor risk awareness and ownership of risk, poor compliance history and/or compliance being viewed as a cost and burden.

Inherent risk considerations

Board and Senior Management Team Composition & Experience

Culture & Composition

Group Relationships

Ownership, Complexity & Controllers

Control considerations

Board and Senior Management Oversight

Policies and Procedures

Internal Controls and Audit

Risk Monitoring and Management Systems

Operational Risk

The risk of loss or harm due to, for example, errors, breaches, incidents, interruption or damage, intentional or otherwise:

>> Caused by inadequate: People, Process, IT Systems or Reliance on Third Party Providers/Outsourcing

>> Caused by External Events

Inherent risk considerations

People

Process

IT Systems

Reliance on Third Party Providers/Outsourcing

External Events

Control considerations

Board and Senior
Management Oversight

Policies and
Procedures

Internal Controls
and Audit

Risk Monitoring and
Management Systems

Prudential Risk

Prudential Risks can reduce the adequacy of a firm's financial resources, and as a result adversely affect confidence in the firm, the financial system or negatively impact consumers. Ultimately, if Prudential Risks are not managed and controlled effectively, it could cause a firm to fail in a disorderly manner.

Inherent risk considerations*

Capital

Liquidity

Credit

Outsourcing and Group Support

Market

* These apply to all regulated firms. Additional considerations are applicable to banks and insurers.

Control considerations

Board and Senior
Management Oversight

Policies and
Procedures

Internal Controls
and Audit

Risk Monitoring and
Management Systems

Strategic Risk

Strategic Risks are internal and external events that make it difficult or impossible for a firm to achieve its chosen strategy. This may occur due to factors such as poor objectives, poor implementation of the strategy (for example, bad decision making), resource issues or failure to identify, understand and respond appropriately to changes in the environment.

Failure to deliver the chosen strategy can result in harm to customers, the firm's reputation, and its ability to attract and retain high-calibre staff. It can lead, at worst, to financial failure.

Inherent risk considerations

Internal

External

Control considerations

Board and Senior
Management Oversight

Policies and
Procedures

Internal Controls
and Audit

Risk Monitoring and
Management Systems



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FINANCIAL SERVICES AUTHORITY

Lugħt-Reill Shirveishyn Argidoil Ellan Vannin