



Jersey Financial Services Commission

From the office of the Director General

Telephone: + 44 (0) 1534 822011
E-mail: s.cadigan@jerseyfsc.org

Your Ref.:

Our Ref.: JH/sc/TCB

20 June 2008

Dear Chief Executive Officer

Financial Services (Jersey) Law 1998 ("the Law")
Common regulatory shortfalls and completion of the transitional Trust Company Business phase

The trust company business sector has recently been the subject of discussion by the Board of Commissioners. The Board felt that it would be helpful to formally advise industry regarding the end of the transitional phase for trust company businesses, and how the Commission proposed to deal with serious and material regulatory breaches in the future, whilst also taking the opportunity to highlight some of the common areas of shortfall which have been seen by the Commission over an extended period. The Board of Commissioners recognises that considerable work had been undertaken and significant improvements have been made by the trust company business sector in general, a sector which was of course quite new to regulatory supervision, when the Law came into force in 2001.

1. The Transitional Phase

Following the wind down of the final transitional applicant, the Commission wishes to make public the fact that the transitional provisions as contained in Article 18 of the Financial Services (Extension) (Jersey) Law 2000, are no longer relevant.

During the extended period of transition, 24 of the original 229 trust company business applicants who had applied by 2 February 2001, have either merged with another company, ceased trust company business or withdrawn their applications, prior to a determination of that application. A further 4 firms have had their applications formally refused.



PO Box 267 14-18 Castle Street St Helier Jersey JE4 8TP
T: +44 (0)1534 822000 F: +44 (0)1534 822001 E: enquiries@jerseyfsc.org W: www.jerseyfsc.org



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Additionally, during this transitional period, 6 firms who had in fact been granted registration, were unable to maintain the required regulatory standards and through working closely with the Commission, voluntarily sought to wind down their affairs by a sale of the underlying customer base or affiliation.

In highlighting the above, the Commission also wishes to make it clear that a number of other applicants or firms who were granted a registration, with whom the Commission had no regulatory issues, have also closed down as a consequence of retirement and/or normal merger and acquisition activity.

2. Common areas of regulatory shortfall

One of the Commission's functions is to *"provide advice, assistance or serviceswith a view to securing the efficient and effective provision of financial services in or from within Jersey"*. It is therefore felt to be useful to identify some of the failings exhibited by both applicant businesses and those that did achieve registration, but were unable to maintain the required standards. These included:

- 2.1 Breaches of the Financial Services (Trust Company Business (Assets - Customer Money) (Jersey) Order 2000 , in respect of the failure to keep adequate records of customer money (Article 2) and/or, reconcile that money (Article 3), not mix that money (Article 5) and not use customer money without authority for another customer (Article 6).
- 2.2 Breaches of the Financial Services (Trust Company Business) (Accounts, Audits and Reports) (Jersey) Order 2000 ("the Order"), in respect of the failure to furnish audited financial statements within the period stipulated by the Order.
- 2.3 Failure to comply with the Trust Company Business Codes of Practice by reference to those issued in October 2001 ("the Codes"), particularly:
 - 2.3.1 *'A registered person must organise and control its affairs effectively for the proper performance of its business activities and be able to demonstrate the existence of adequate risk management systems' (fundamental principle 3)*. The Commission found that there were failures of corporate governance with particular reference to the frequency of board meetings held and the need to document deliberation of the types of matters that would typically be expected, for example reports from the MLRO and compliance officer, new and lost business or financial matters. Additionally where sub-committees were formed they were not always given particular terms of reference



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and nor were they always required to report back to the main board. Additionally where a business acts as the Manager of a managed trust company, some periodic assessment of their continued effectiveness in the role would be expected.

In the context of risk management, the Commission was, for example, very concerned that Politically Exposed Persons had not been identified as such and additionally, where such clients operated from high risk jurisdictions, inadequate due diligence was held and inappropriate client risk gradings applied.

- 2.3.2 *'Any delegation of duties or powers, whether by Powers of Attorney or otherwise, should only be entered into for a proper purpose, limited and monitored as appropriate'* (section 2.6). The Commission found, for example, that general Powers of Attorney, were not all recorded or adequately monitored and on occasions, insufficient due diligence was held on the underlying attorneys and their activities.
- 2.3.3 *'A registered person must operate robust arrangements for meeting the standards and requirements of the regulatory system, including guarding against involvement in financial crime and ensuring that all transactions or decisions are appropriately authorised by persons with requisite knowledge and experience to effect such transactions or make such decisions'* (section 3.1.4). The Commission found, for example, that for several client trading companies (including some receiving commissions on arms sales), inadequate documented information was held to demonstrate a full understanding of the underlying company's activities. In addition, staff administering such companies sometimes had insufficient knowledge to be able to properly discharge their roles as administrators and directors.
- 2.3.4 *'A registered person must comply with the Proceeds of Crime (Jersey) Law 1999, the Money Laundering (Jersey) Order 1999 and follow standards set out in the Anti-Money Laundering Guidance Notes issued by the Commission'* (section 3.1.6). For example, the Commission found various businesses had: no documented procedures to achieve timely reporting of suspected clients, low levels of money laundering awareness, poor record-keeping and post-July 1999 clients whose identities had not been adequately verified.



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2.3.5 *'Compliance with paragraphs 3.1.3 and 3.1.5 requires a registered person to maintain adequate internal controls and to keep not only adequate and orderly accounting records but also adequate and orderly records of its internal organisation and its risk management systems'. 'The registered person must therefore: - document systems and procedures intended to safeguard trust company business assets and to ensure that only authorised and proper transactions are undertaken' (section 3.7.1.2) and 'ensure that the records prepared under paragraphs 3.7.1.1 and 3.7.1.2 are updated as required' (section 3.7.1.3.)* The Commission found, for example significant shortcomings in the systems for the monitoring of investment portfolios and the production of client financial statements, which in certain cases had not been produced for several years.

2.4 The monitoring of a business's financial standing is a key regulatory requirement, however widespread shortcomings have been seen in the calculation of businesses' adjusted net liquid assets ("ANLA") position as required by the financial resources section of the Codes. These shortcomings included the failure to perform the calculation on a quarterly basis, failure to report the ANLA position to the board regularly, failure to report breaches to the Commission on a timely basis and basing the 'expenditure requirement' on the lower of prior year actual expenditure and budgeted expenditure for the coming year, rather than the higher of the two figures, as required by the Codes.

3. Material Regulatory Breaches - future stance

Since trust company regulation came into force, the Commission has attempted to assist businesses, to both meet and maintain compliance with the regulatory regime through the provision of expert reports, meetings with the Commission and ultimately giving more time to rectify the deficiencies identified. Given that the trust company business sector was generally new to regulation, it was felt this was a pragmatic approach. Against this, the Commission has also had to use various regulatory powers to ensure that both the underlying clients and the reputation and integrity of the Island were safeguarded. These powers have included the use of powers of direction, appointment of a reporting person, appointment of co-signatories, the commencement of refusal proceedings, appointment of a Manager, the general power to provide information and documents and of course, regulatory on site examinations.



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With the ending of the transitional regime, the Commission now wishes to advise that these intense levels of assistance and extended periods of remediation will no longer be afforded to trust company businesses where serious and material breaches are identified. Consequently, where businesses fail to meet the required regulatory standards, whether it be through serious breaches of the regulatory regime (albeit some latitude will be given where such a breach emanates from recent regulatory revisions), or repeat findings identified during on site examinations evidencing a failure to adequately remedy previous issues similarly identified, then action will be taken. Such action may, depending on the seriousness of the situation, and the degree of openness adopted by the trust company business range from the issue of a formal written warning, which may be made available to other regulatory bodies relevant to the business, through to the ultimate sanction namely a revocation of the businesses registration, coupled with a review of the culpability of individuals involved and if appropriate a public statement. **It is of course recognised that minor breaches can occur and reference should also be made to** the 'Guidance on the Commission's Decision-Making Process', the 'Guidance on the Commission's use of Enforcement Powers', and the 'Guidance on the Commission's use of Public Statements', which are all published on the Commission's website.

In relaying this revised stance, the Commission wishes to advise that it will still operate a commonsense approach in dealing with breaches and wishes businesses to maintain an open dialogue with the Commission at an early stage and to work with the Commission in dealing with any breaches that occur or which have the potential to occur. Early liaison, self disclosure to the Commission and the outline of remedial actions either already identified or already actioned will always be major factors to take into consideration when determining what, if any action the Commission should undertake. I would thus urge you to adopt an open and transparent dialogue with the Commission at the earliest opportunity in the event that any form of breach occurs.

As part of its statutory function, the Commission feels it is helpful to provide specific guidance to industry on its findings and observations. Article 8(3)(c) of the Financial Services Commission (Jersey) Law 1998 envisages that the Commission will, "*publish, in such manner as it considers appropriate, such information relating to its functions as it thinks fit*". I hope you agree that the Commission's future stance is a reasonable one given the time since regulation was introduced and the need to ensure that the high standards present in the trust sector are extended to all participants. Ultimately this is essential in order that Jersey continues to be recognised as a leading jurisdiction.



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I would like to take this opportunity of thanking everyone for their hard work in developing compliance within the regulatory framework over the last seven years and look forward to working with you to meet the challenges and developments that face us all in the future.

Yours faithfully

A handwritten signature in black ink that reads "John Harris". The signature is written in a cursive style with a long, sweeping underline.

John Harris
Director General