Jersey Financial Services Commission

TRUST COMPANY BUSINESS

ON-SITE EXAMINATION PROGRAMME 2009
SUMMARY FINDINGS

DOCUMENT OVERVIEW

1 Introduction

1.1 During 2009 the Jersey Financial Services Commission (the "**Commission**") continued its programme of on-site examinations as part of its supervision of trust company businesses.

1.2 The purpose of an on-site examination is to assess a business in terms of its performance against the legislative and regulatory framework, i.e. Laws, Orders and Codes of Practice. The objective in publishing summary findings from a programme of on-site examinations is to share experiences as to how different trust company businesses seek to meet the requirements of the regulatory framework and to highlight the difficulties that are sometimes encountered.

2 Scope

2.1 The Commission undertook a range of on-site examinations during 2009 using discovery, focused and themed techniques to review a broad spectrum of businesses. There were two types of themed examination undertaken, with the majority falling into the category of anti-money laundering/countering the financing of terrorism (**"AML"**) and the remainder being conduct of business.

2.2 The AML examinations took a narrow, but in depth view of a business's compliance with Section 2 of the Handbook for the Prevention and Detection of Money Laundering and the Financing of Terrorism for Financial Services Business Regulated under the Regulatory Laws (the **"Handbook"**), namely corporate governance. Particular emphasis was given to the content and effectiveness of the business risk assessment prepared by the trust companies selected for this themed examination, and their formal written strategy to counter money laundering and the financing of terrorism.

2.3 The conduct of business examinations focused on the manner in which a trust company provided services to its customers, by way of examining a sample of customer files and records. This gave the Commission a valuable insight into the standards of administration within the business, measured not only against the business's own policies and procedures, but also against its peers.

3 Process

3.1 Businesses were selected on the basis of their risk rating and their past examination history. Each business selected for an on-site examination was asked to complete a self-assessment questionnaire, covering a range of questions, depending on the theme or type of the examination. Responses to the questionnaire were analysed, areas of potential concern were identified, and this then set the agenda for the examination.

3.2 Generally, on-site examinations encompassed an assessment of the businesses' policies and procedures in relation to the specific areas being examined. Commission officers reviewed, on a sample basis, the records and files maintained by the trust company and held discussions with management and staff involved in operational and compliance matters. Results were then measured against the trust company's procedures and the relevant legislative and regulatory framework.

4 Overview

4.1 A total of 56 on-site examinations were conducted during 2009, compared with 53 in 2008. Of this number, 23 comprised AML corporate governance themed examinations and four looked specifically at conduct of business, with the remaining 29 being split between discovery and focused examinations.

4.2 The action taken by the Commission as a result of the on-site examination programme was dependent on the materiality of the findings and is summarised below:

Action	**2009 Number**	**2009 Percentage**	**2008 Percentage**
Enforcement action taken (for example directions issued or co-signatories appointed).	4	7%	2%
Heightened supervision during the period of remediation, including follow up examinations and regular meetings with management.	3	5%	17%
Formal monitoring of implementation of corrective action plan, via Post Examination Monitoring Schedule.	24	43%	41%
No formal monitoring.	25	45%	40%
Totals	**56**	**100%**	**100%**

4.3 In line with the Commission's 'CEO Letter for the TCB Sector' letter issued in June 2008, it can be seen that the number of cases where the Commission has taken enforcement action has increased. As stated in the letter, following the end of the transitional regime the Commission will no longer afford regulated businesses the intense levels of assistance and extended periods of remediation that have occurred in the past. Accordingly, enforcement cases in 2009 include cases that may have previously been dealt with under heightened supervision, which has seen a corresponding fall.

4.4 It is disappointing to note that, excluding those cases where enforcement action has been taken and heightened supervision has been in place, over 40% of businesses examined have required remediation supervised by the Commission, as a result of issues surfaced during on-site examinations.

4.5 However, in 45% of cases examined, any failings identified have not been serious enough to require the Commission to put in place formal monitoring, and the Commission has been able to work with the business concerned to ensure that appropriate remediation is carried out, and the business is brought back in to compliance, where applicable.

4.6 The Commission will be monitoring these trends carefully, as it should be expected that this latter figure will continue to improve as businesses' levels of compliance increase without the need for formal Commission intervention.

5 Findings arising from AML corporate governance themed examinations

Business Risk Assessment and Strategy

5.1 The requirement to prepare a business risk assessment and strategy was introduced in the Handbook in February 2008 and thus the Commission would have expected all businesses examined during 2009 to have prepared and approved their risk assessment. Whilst only one of the businesses examined had failed to prepare a risk assessment and strategy at all, the Commission was disappointed to note that in 12 further cases although a risk assessment had been completed, no strategy had been prepared.

5.2 There were also a significant number of cases where a risk assessment and strategy had been prepared but not approved by the board, thus effectively remaining in draft.

5.3 The most common finding with regard to the risk assessment and strategy was the failure by businesses to include adequate detail in the risk assessment (guidance on this is set out in section 2.3.1 of the Handbook), or indeed to identify the specific risks applicable to their own business. For example, a number of businesses had produced documents that set out the risks applicable to the trust industry in general, but then failed to consider the risks specific to their own business and arising from their own customer base. Without a detailed, specific risk assessment, it is then difficult to produce a meaningful strategy. As stated in the 2008 examination feedback report, the strategy should be based upon the risk assessment, and there should be a clear connection between the risk assessment, strategy and policies and procedures.

5.4 There were a few cases where the business had prepared its risk assessment and strategy at an early stage but had not yet revisited it. Whilst the Handbook does not require an annual review of the risk assessment for all businesses, directors should be aware of changes taking place within their operations and customer bases and revisit the risk assessment on an appropriately regular basis. A periodic review of the risk assessment also affords the directors an opportunity to step back and take an objective view of the business which may be lost sight of during day to day 'business as usual'.

Customer Profiling and Transaction Monitoring

5.5 The requirement to monitor transactions is set out in Article 13 of the Money Laundering (Jersey) Order 2008 (the "**MLO**"). Section 5 of the Handbook requires a regulated person to capture sufficient information about a customer that will allow it to develop a profile of expected activity sufficient to provide a basis for recognising unusual activity and transactions, and identify higher risk activity or transactions which may indicate money laundering or financing of terrorism.

5.6 Whilst the Handbook does not dictate the form that a profile should take, businesses that had a robust approach to transaction monitoring typically included the following in their customer profiles:

5.6.1 Beneficial ownership or control;

5.6.2 Details of other connected relationships (e.g. a group structure) including underlying companies;

5.6.3 Services provided to the customer;

5.6.4 Nature of entity's activities and geographical sphere;

5.6.5 Rationale for the structure; and

5.6.6 Type, volume and value of expected activity.

5.7 The Commission would also expect businesses to set out in their procedures the trigger events that would require a customer profile to be updated.

5.8 In conducting file reviews, the Commission noted that in many cases, customer profiles were inadequate inasmuch as they did not contain sufficient detail to facilitate transaction monitoring. In order for a profile to be effective, it must contain a certain minimum level of information and detail. The rationale for the structure must also be clear, and the Commission was disappointed to note that in almost 30% of businesses examined, the customer files reviewed did not demonstrate an adequate understanding of the structure.

5.9 The Commission was concerned to note a number of instances examined where no customer profiles had been prepared at all. There were also cases where a proportion, but not all, of the customer base had been profiled. For example, customers taken on after the implementation of the MLO and Handbook had been profiled, but the trust company business had not done so for the existing book of customers. In cases where profiles have not been prepared, the Commission observed a dependency on the knowledge of directors and/or staff, which can be inefficient and unreliable. Such knowledge is likely to be unavailable when the relevant staff member is absent, and can be lost altogether should the staff member leave the organisation.

5.10 The Commission also encountered situations where sufficient information relating to the customer to form a profile was held by the business, but such information was held in disparate places on the files and not summarised in one central area. In these cases, the Commission would consider that the regulated person would find it difficult to demonstrate compliance with the requirement in section 8 of the Handbook for customer due diligence ("**CDD**") information to be recorded and stored in a way that facilitates periodic updating of the information. This requirement is designed to assist businesses to monitor transactions in the most efficient manner.

5.11 The guidance in the Handbook states that monitoring may involve both real time and post event monitoring. The most common finding with regard to transaction monitoring was a failure to put in place a mechanism to monitor transactions retrospectively. Many businesses have procedures whereby payments and receipts are compared to the customer profile on an arising basis, but not all businesses demonstrated a regular retrospective review. This can most easily be accomplished by the inclusion of a question in the periodic review form asking the reviewer to compare transactions during the period to the customer profile.

5.12 Businesses need to be aware that should a transaction not be in accordance with a profile, it is not sufficient simply to note the fact, nor to just assume that the profile needs to be updated. Follow up action must be taken to determine whether there is a legitimate explanation for the unusual activity, or whether a suspicious activity report needs to be made.

Introducers and Intermediaries

5.13 The most common findings by the Commission in this area were:

5.13.1 A failure to understand the distinction between an introducer and an intermediary, resulting in reliance being placed on the wrong concession under the MLO;

5.13.2 A failure to appreciate the need to carry out a risk assessment on the introducer or intermediary, and that the introducer or intermediary must either be a person regulated by the Commission, or carrying on an equivalent business (as defined in Article 5 of the MLO);

5.13.3 The failure to obtain all the assurances required from the introducer, as set out in Article 16 of the MLO. A proforma introducer's certificate is included in Appendix C of the Handbook.

5.14 It should be noted that the above findings were relatively few in number compared to the number of businesses examined, as in practice many businesses have advised the Commission that they do not rely on the concessions afforded by Articles 16 and 17 of the MLO, and prefer to obtain full due diligence for all customers themselves. The Commission would therefore like to remind all businesses that do use these concessions, to make sure that they understand, and have complied with, the conditions that must be satisfied before the concessions can be relied on.

5.15 This is important because, as stated in Article 16 of the MLO, notwithstanding any reliance on the concessions set out in that Article, each business remains responsible for any failure by an introducer or intermediary to apply identification measures.

6 Findings from other on-site examinations

6.1 The observations detailed below have been drawn from findings across all types of on-site examination conducted in 2009.

General Corporate Governance

6.2 In 2009, corporate governance deficiencies were found in 45% of businesses examined, as compared to 66% in 2008. The Commission is pleased to note an improvement, but nevertheless remains concerned at the high percentage of findings relating to corporate governance practices in industry.

6.3 The most common finding noted by the Commission was again the failure to adequately document the terms of reference for committees established to manage specific areas of the business on behalf of the board of directors. The Commission's expectations in this area were set out in the 2008 examination feedback report.

6.4 It should be particularly noted that the use of a committee does not relieve the board of its responsibilities in respect of the matters delegated to the committee. It is important that the board monitors the activity of the committee, that the committee reports regularly to the board and that such reporting is recorded in the board's minutes.

6.5 The Commission is still seeing cases where board meetings are held irregularly, and would like to remind businesses of the importance of holding board meetings on a regular basis (at least quarterly), and the use of a comprehensive standing agenda for board meetings.

6.6 Businesses should note that the Commission will continue to include corporate governance in the scope of its on-site examinations on an ongoing basis to further monitor performance and standards in this area.

Policies and Procedures

6.7 The Commission found inadequacies in procedures in almost a third of businesses examined. The most common finding was that specific procedures had been omitted from a business's procedures manual, for example procedures relating to monitoring transactions undertaken by customer entities, the review of new business within a specified time period after acceptance, or the provision of limited services (including registered office only).

6.8 In two cases, businesses were following procedures manuals that were wholly or partly in draft, having not yet been approved by the board. Further to the comments made in the 2008 examination feedback, the Commission would expect formal systems to be in place to ensure the timely approval of new or amended procedures.

6.9 Deficiencies in procedures were also noted in a number of cases, most frequently in the area of new business acceptance. Such deficiencies included errors in procedures and AML manuals where the business has failed to update the manuals to comply with new or revised legislation, or where references to Laws, Orders and Codes were incorrectly recorded. It is vitally important that businesses keep abreast of changes and updates to the regulatory regime and ensure that these are incorporated into policies and procedures manuals.

Compliance Monitoring

6.10 As noted in last year's examination feedback, the Commission places considerable reliance on a business having a robust and effective compliance function. The Codes of Practice for Trust Company Business (the "**Codes**") require the Compliance Officer to ensure appropriate monitoring of operational performances, and in order to comply with this the Commission would expect all businesses to have in place a comprehensive compliance monitoring programme incorporating a review of operational processes and legal and regulatory requirements.

6.11 Businesses with an effective compliance monitoring programme were able to demonstrate that the results of such compliance monitoring were reported to the board on a regular basis. Doing so helps evidence compliance with the Codes and Handbook, and is indicative of good corporate governance.

6.12 Our 2009 examination programme revealed six businesses where no compliance monitoring programme was in place. In two of those cases a draft programme had been developed, or was in the process of being developed, but had not yet been implemented.

6.13 In a further seven cases, a compliance monitoring programme was in place, but the scope was insufficient. For example, limiting compliance monitoring to a review of customer files without considering the wider systems and controls in the business to ensure compliance with legal and regulatory requirements would be considered insufficient.

The Provision of Limited Services (including Registered Office only)

6.14 The provision of limited services is an area of increasing risk for Jersey as a jurisdiction and indeed for the providers of this service. The risk arises because the nature of the service is such that a business is unlikely to have any oversight of, or control over, the customer company's activities. The absence of such oversight or control increases the risk that a Jersey company may be used to launder money or to finance terrorism. This risk can be mitigated to an extent by a service provider having robust systems and controls in place with regard to this type of business.

6.15 The Commission recommends that all businesses providing limited services to customers should establish a clear, documented policy and procedures covering these services. Such policy and procedures should include the circumstances in which such services will be provided, the risks posed by this service offering, and the level of due diligence and monitoring required. These risks and the appropriate mitigators should also be considered in the business's risk assessment and strategy, and thus flow into policies and procedures.

6.16 Businesses will be aware that the Commission recently published Trust Company Business sector specific guidance as an addition to the Handbook. The guidance addresses the issue of registered office only business and says that, in order to demonstrate the collection of sufficient information about a customer, providers of this service, as well as obtaining due diligence on the beneficial owners and directors of the customer companies, should obtain copies of minutes of directors' meetings and copies of accounts prepared for those companies. This is in addition to the statutory records required to be kept at the registered office as set out in the Companies (Jersey) Law 1991. The Commission expects these requirements to be incorporated into businesses' policies and procedures, as noted above.

6.17 The Commission's most common finding with regard to registered office only business was the absence of a documented policy and procedure concerning the provision of this service. In these cases, when a sample of limited services relationships were reviewed by the Commission it was clear that a lack of policies and procedures had lead to an absence of heightened oversight or, in some cases, any oversight at all.

6.18 The Commission encountered a small number of businesses where open source information was not regularly monitored in respect of registered office only business. This can be a useful way of monitoring such companies where contact with the customer is limited.

6.19 The Commission also found two businesses where their risk rating systems did not automatically elevate registered office only business to 'high risk'. The Commission's expectation is that registered office only business should be rated as 'high' unless significant mitigating factors can be demonstrated.

Geographical Risk

6.20 Another area where Jersey may be vulnerable to reputational risk is the provision of services to customers connected to higher risk jurisdictions.

6.21 The Commission found a number of issues relating to geographical risk during its examination programme:

6.21.1 The lack of consideration of geographical risk in the business risk assessment and strategy. This is clearly highly relevant where a business has a significant proportion of customers associated with higher risk jurisdictions. A failure to consider the risks at this level may result in policies and procedures which do not provide sufficient mitigation of the risks inherent in the business.

6.21.2 Use of a risk rating system which failed to identify geographical risk. An effective evaluation of geographical risk would typically include the consideration of Financial Action Task Force ("**FATF**") blacklists, international sanctions, and countries considered at high risk of corruption, drug trafficking or terrorist financing. The risk rating process should consider the jurisdiction of the beneficial owners as well as the jurisdiction in which the customer entity is operating and with which it has trading relationships, where applicable.

6.21.3 The take-on of new business associated with a higher risk jurisdiction without performing adequate enhanced CDD measures or properly assessing country risk. Article 15 of the MLO requires enhanced CDD measures to be applied where the prospective customer is connected with a country or territory that does not apply or insufficiently applies the FATF recommendations (currently only Iran is listed). In addition, Appendix D of the Handbook includes a list of countries that are considered to present a higher risk for the purposes of assessing geographical risk (e.g. Pakistan and Turkmenistan). Section 3.4.3 of the Handbook sets out examples of enhanced due diligence measures.

6.22 When evaluating the risk rating of a customer associated with a higher risk jurisdiction, a regulated business should also consider applying similar considerations to the introducer of the business and to intermediary business, especially where a chain of introducers or intermediaries exists.

Customer Money

6.23 During the 2009 examinations the Commission found a number of cases where businesses had breached the requirements of the Financial Services (Trust Company Business (Assets – Customer Money)) (Jersey) Order 2000 (the "**Customer Money Order**"). It is therefore considered timely to remind business of their obligations under this Order.

6.24 The key findings were:

6.24.1 The failure to obtain an undertaking from the bank in respect of a customer pooled bank account as required by Article 7 of the Customer Money Order;

6.24.2 A lack of clarity, either in procedures or the terms and conditions issued to customers, regarding the circumstances when interest is paid to customers.

6.25 In a small number of cases, pooled accounts had not been reconciled regularly, and customer money had been mixed with other money.

7 Conclusion

7.1 The foregoing is not intended as formal regulatory guidance, nor should it be taken to cover all aspects of the subjects touched upon.

7.2 As noted in previous on-site examination feedback reports, the Commission recognises the efforts of the majority of trust company businesses to improve and upgrade their systems and controls on a continuing basis.

7.3 The implementation of the new Handbook and MLO has affected all businesses, although some have implemented the necessary changes more effectively than others. As a consequence of some of the findings noted in this report, the Commission's main theme for examinations in 2010 will be AML – Customer profiling and transaction monitoring.

7.4 Additional themes for 2009, covering new areas that the Commission wishes to examine, will be registered office only business and the administration of private trust companies. The Commission will also continue to examine Conduct of Business.

7.5 Any comments on the content of this paper would be welcomed. The Commission would also be happy to address any concerns or questions that the reader may have on matters raised herein. Any such communications should be addressed to:

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