Jersey Financial Services Commission

Trust Company Business
On-site Examination Programme 2007
Summary Findings

Introduction

During 2007, the Commission continued to focus resources on the supervision of trust company businesses through the on-site examination programme.

The purpose of an examination is to assess a business in terms of its performance against the relevant laws, orders and codes of practice. The objective in publishing summary findings from a programme of examinations is to share experiences as to how different firms seek to meet the requirements of the regulatory regime and to highlight the difficulties that are sometimes incurred.

Scope

The on-site examination programme for 2007 focused on several key themes:

- Anti-money laundering (“AML”);
- Corporate governance;
- Financial resources; and
- Risk management.

The summary findings from the AML themed programme were the subject of a separate paper dated 25 January 2008. This paper will focus on the findings from the remaining themes and from the general examinations of a wider scope, which were undertaken during the year.

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 registered person and held discussions with management and staff involved in operational and compliance matters. Results were then measured against the procedures and the relevant legislative and regulatory framework.

Process

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

Overview

A total of 72 examinations were conducted during the course of 2007, compared with 32 in 2006. Of this number, a total of 16 comprised the AML themed examinations, which were undertaken on behalf of the Commission by Deloitte & Touche LLP (see the Anti-Money Laundering Themed Examination Programme 2007 - Summary Findings dated 25 January 2008). The remaining 56 examinations were undertaken by the trust company business team and focused on the themes outlined above.

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 as follows:

Action	**2007 Number**	**2007 Percentage**
Enforcement action	2	2.78
Follow up examination	8	11.11
Monitor implementation of recommendations	33	45.83
No formal monitoring	29	40.28
Totals	72	100

Findings

The observations detailed below have been drawn from on-site findings:

<u>Corporate Governance</u>

Deficiencies in corporate governance were found in 62% of the trust companies examined during 2007. Given that approximately the same percentage of deficiencies was found in 2006, this would indicate that there continues to be scope for improvement in this important area.

In some cases, board meetings were held infrequently on an ad hoc basis with no standing agenda. The Commission's expectations are that board meetings are held on a regular basis, at the very least quarterly and preferably monthly, to deliberate important matters relevant to the trust company business' registration. Items which would be expected to form part of a standing agenda, would include such matters as:

- New Business
- Lost business
- Complaints
- Litigation
- Professional indemnity insurance matters
- Financial position
- Compliance report
- Report from Money Laundering Compliance Officer and Money Laundering Reporting Officer

Following the publication of the new AML Handbook, such matters as the business's strategy to counter money laundering and the financing of terrorism and the business risk assessment would also be expected to be the subject of periodic formal review by the Board.

Many businesses choose to establish underlying committees to manage specific areas of the business on behalf of the board, for example: risk, audit, business acceptance. However, a common finding was the failure to document terms of reference and reporting back to the board in respect of these committees.

Some trust company businesses offer the service of acting as the Manager of a managed trust company. A business is selected for this important role on the basis of its superior systems and controls and corporate governance. It is essential that any business in this position ensures that high standards are maintained in respect of the performance of this role. This could be demonstrated by way of a periodic self-assessment of the effectiveness of its role as Manager. However, there was little evidence that businesses were taking steps to ensure that standards were being maintained in this respect.

Arms and Anti Corruption Guidance Note dated 9 March 2006

The Commission was disappointed to note that 33% of businesses had either failed to consider their policy, in respect of being associated with activities that lead directly or indirectly to the supply of arms or anti-corruption provisions adopted by the Sates of Jersey, or failed to document the review of their customer base in accordance with the requirements of the Guidance Noted dated 9 March 2006. A copy of the Guidance Note can be found on the Commission's website:
www.jerseyfsc.org/trust_company_business/guidance_notes/index.asp

Financial Resources

A new theme was introduced into the examination programme for 2007, covering the methodology used by businesses in the calculation of their adjusted net liquid assets ("ANLA") position as required by section 5.2 of the Trust Company Business Codes of Practice ("the Codes"). The Commission was concerned that there may be some discrepancies in this area and it was decided that this would be a useful theme to pursue.

Issues were found in virtually all of the businesses where this topic was examined. These ranged from the failure to perform the calculation on a quarterly basis to concerns regarding the methodology of the calculations. One of the most significant recurring issues was the failure to report the ANLA position to the board on a regular basis, thereby leading to concerns regarding the quality of the corporate governance.

In some isolated cases, there was a failure to report breaches of the financial resource requirement to the Commission on a timely basis as required by Section 5.3 of the Codes.

A recurring theme regarding the methodology was that the expenditure requirement was sometimes based on the lower of prior year actual expenditure and budgeted expenditure for the coming year, rather than the higher of the two figures.

Procedures

The Commission found 25% of businesses to have inadequate procedures. In one or two instances, albeit in relation to single class of business operations, there were no procedures at all. In one case, a business offering the full range of trust company services was reliant on a combination of an incomplete procedures manual and informal checklists and procedures, which had not been reviewed or approved by management. In other cases, the written procedures did not reflect what was actually being undertaken in practice or did not cover key areas of the business, such as the risk rating of customers.

Business Acceptance

Some new business procedures were not sufficiently comprehensive so as to ensure that enough information was obtained and documented to allow full consideration of each new business enquiry. For example, where the procedures did not provide for full documentation of the source of wealth and rationale for the structure, it was difficult to understand how the business could monitor transactions and determine whether they are consistent with the pre-determined profile.

In three cases, the business did not have a procedure in place for an initial review to be conducted once the new business had been accepted, to ensure that the transactions undertaken were in line with expectations and that all administrative matters had been completed. The Commission would consider this to be an important control in respect of the business acceptance process and is certainly one adopted by most trust company businesses.

Risk Rating System

Overall, good progress continues to be made in the quality of customer risk rating systems, although the Commission continued to find examples where the risk rating of a particular customer was inappropriate. For example, a company established to provide consultancy services on behalf of a high profile customer, with incomplete background information was rated as medium risk. In such circumstances, it is difficult to understand how such an entity would be rated as less than high risk, at least until such time as full documentation has been obtained so that the rationale is clearly understood. The Commission would expect a risk rating system to automatically elevate all customers who are politically exposed persons into the high risk category.

Where a business is reliant on business being introduced by intermediaries, it is apparent that businesses have not always undertaken background checks in respect of the intermediaries as well as the underlying customers. The Commission would suggest that consideration should be given as to whether there is a higher customer risk profile for books of business connected to certain intermediaries. It may also be useful to monitor books of business over a period of time to consider whether the risk profile of customer entities associated with particular intermediaries shows an upward trend.

Unauthorised Business

The Commission found that approximately 15% of businesses were operating outside of the scope of their registration. The majority of these breaches were at the minor end of the scale and related to very small operations undertaking a single class of business, where they had inadvertently strayed into related areas. However, the Commission does take such breaches seriously and will, in the more serious cases, consider taking regulatory action where appropriate.

Backlogs

It was noted that many businesses are continuing to work to reduce historic backlogs in updating customer due diligence information, the preparation of financial statements and dealing with periodic reviews.

Conclusion

Whilst the Commission is encouraged by the overall improvement in standards, it continues to encounter isolated incidents of very poor practice. Given that the industry has been regulated for some seven years, the Commission will, in such circumstances, now consider the use of the full range of regulatory sanctions available including the use of public statements where appropriate.

The Commission has observed a continued trend of consolidation within the industry, with many businesses taking advantage of the resultant economies of scale. In this regard, the Commission has noted that in many cases, the resources required to address issues in the target business are significantly underestimated by the acquirer.

The Commission recognises the efforts of the vast majority of the industry to continuously improve and upgrade their systems and controls. The assessment of risk will continue to be an important focus during 2008, given the requirements of the new anti-money laundering framework.

The examination programme for 2008 will focus on the conduct of business, that is the manner in which a trust company provides services to its customers. This will involve a greater proportion of time being spent on the review of customer files during the course of the examination.

Any comments on the contents of this paper would be welcomed. We 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:

Janice Kearsey
Senior Examiner, Trust Company Business
Jersey Financial Services Commission
PO Box 267
St Helier
Jersey JE4 8TP

Direct Dial: +44 1534 822025
Direct Fax: +44 1534 822002
Email: j.kearsey@jerseyfsc.org

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