# Investment Business
# On-site Themed Examination Programme 2007

## Summary Findings
## May 2008

### Introduction

During 2007, the Commission carried out a series of themed on-site examinations to examine specific areas of conduct within a cross section of the investment business industry.

The objective in publishing these summary findings is to share experiences as to how different firms have sought to satisfy the requirements of the regulatory regime and to highlight the difficulties that sometimes arise.

### Scope

The themed on-site examination programme for 2007 focused on three key areas:

- Suitability of Advice;
- New products and services – due diligence; and
- Human Resources.

The summary findings from the Suitability of Advice themed programme are set out within a separate paper published by the Commission entitled "Findings of mystery shopping research – Suitability of Advice and Sales Process of Regulated Investment Businesses".

This paper concentrates on the findings from the remaining two themes and also provides findings from other examinations that may have general applicability to the industry.

### Process

The examinations conducted encompassed an assessment of the registered person's relevant policies and procedures. Commission Officers also reviewed a sample of 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 registered person's own procedures and the relevant legislative and regulatory framework.

Businesses were selected on the basis of their risk rating and their past examination history and were chosen in order to provide a cross-section of the investment business industry. Each business selected for an on-site themed examination was requested to complete a self-assessment questionnaire, covering a range of issues. 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 10 themed examinations were conducted by the Investment Business team during 2007. The businesses visited ranged from small independent financial advisers to large retail Banks.

**Findings**

Corporate Governance

The Commission made recommendations in relation to corporate governance to 80% of the businesses that were examined. Whilst the majority of businesses were able to produce minutes from Board and Management meetings, the meetings tended to be held infrequently and often did not address all areas of the business.

The Commission’s expectations are that Board meetings are held on a regular basis (determined by the size of the business, the nature of the activities and its risk profiles), but at the very least quarterly. Items which would be expected to form part of a standing agenda would include the following:

- Investment business related issues, e.g investment performance, market information, clients and target markets, new products or new business acquired, review of the “White List”;
- Financial position;
- Complaints;
- Strategy/Business Planning;
- Operational Issues;
- Risk Management;
- Report from Compliance Officer;
- Report from Money Laundering Reporting Officer and Money Laundering Compliance Officer;
- Litigation;
- Claims under Professional Indemnity Insurance; and
- Human Resources matters.

Compliance Monitoring

In 60% of businesses that were examined, one of the duties undertaken within the compliance function included the Compliance Manager signing off a standard checklist upon acceptance of the new client/business relationship.

In the majority of cases, the checklist was geared towards evidencing the receipt / delivery of documentation, i.e. fact find, investment agreements, reason why letters and client due diligence. Insufficient consideration had been given to providing an objective check on the suitability of the advice provided or the product sold.

In two out of 10 cases the business had employed the services of an independent compliance consultant who had produced an external report suggesting numerous recommendations and remedial action. However in these cases the businesses did not appear to have fully implemented the recommendations that they had received.

The Commission was disappointed that a number of the businesses examined had not considered the wider scope of the compliance function and had failed to establish structured compliance monitoring programmes to detail the frequency of monitoring and responsibility.

Paragraph 3.6.2.2 of the current Investment Business Codes of Practice states; *"the compliance officer is responsible for securing appropriate monitoring of operational performance and promptly instigating action to remedy any deficiencies".*

New Products and Services – due diligence

The Commission established that in seven out of 10 cases, verbal discussions had taken place regarding the evaluation of new products and services but that no formal policies or procedures had been documented setting out the criteria for such an assessment.

The Commission would expect a business to have in place procedures relating specifically to the introduction and integration of new products and services. Such procedures should, as a minimum, provide for the following:

- An initial review of the new product or service by senior management for the purposes of providing initial approval/endorsement;
- A risk assessment of new products and services, which should be documented and consistent with general risk policies;
- Completion of a new business proposal form, which might cover the following:
    - Product/service description;
    - Reasons for the new product/service;
    - Marketing material, key features document;
    - Fees and charges;
    - Investment Objectives;
    - Risk Assessment;
    - Target investors;
    - Advertising;
    - New agency agreements/terms of business;
    - Staff training and higher level qualifications;
    - Notification to regulatory authorities regarding new activity or source of income; and
    - Notifications to Professional Indemnity Insurers.

Mid-Term Cancellation Register

The Commission noted that 50% of the businesses examined did not maintain a mid-term cancellation register. The Commission would expect a business that has advised a client to cancel an investment product to maintain a central register to record this action. The details recorded on the register should include, but not be limited to:

- client name;
- details of the existing investment;
- details of the new investment;
- date of cancellation;
- details of all costs incurred; and
- authorisation of senior management or compliance, as may be necessary.

The client should also be provided with a recommendation letter detailing why this course of action is in their best interest.

Job Descriptions

The Commission established that in a number of smaller businesses, staff had not received formal job descriptions detailing their roles and responsibilities. This is considered a requirement under paragraph 3.1.3. of the current Investment Business Codes of Practice and is also sound practice for all employers.

Staff Handbook

In the majority of cases, the business had adopted a staff handbook that included procedures relating to human resources issues. However, in 40% of businesses examined there were no formal procedures in respect of recruitment, vetting and screening of new employees and obtaining documentary evidence of qualifications. It was also noted that in 20% of businesses examined, exit interviews were not undertaken.

Paragraphs 3.1.1, 3.1.2 and 3.1.5 of the current Investment Business Codes of Practice set out the regulatory requirements for a registered person in this respect.

On 7 December 2007, the Commission issued a press release in respect of Jason Warner, who criminally and fraudulently used a false Oxford University degree certificate and/or a Curriculum Vitae to obtain or attempt to obtain a salary.

The press release can be located as follows;

http://www.jerseyfsc.org/the_commission/general_information/press_releases/release214.asp

Succession Planning

The Commission was pleased to note that seven out of 10 businesses examined had considered the issue of succession planning for key employees and how the business could seek to remain in compliance with the Commission's span of control requirements.

This is a particularly important issue as over the last few years the Commission has witnessed a number of occasions where a director has resigned or left the employment of a business at short notice, leaving the business to be managed by only one or two directors for an interim period. In these circumstances, the Commission will work with the business involved in order to ensure that the business can continue to comply with its regulatory requirements.

Unauthorised Business – General Insurance Mediation Business

The Commission found that 30% of the investment businesses examined were operating outside of the scope of their registration. Policies such as stand-alone Critical Illness Cover and Private Medical Insurance are general insurance products and can only by sold by entities that are registered under Article 9 of the Financial Services (Jersey) Law 1998 to conduct General Insurance Mediation Business.

In these instances, the business was advised to contact the Commission's Insurance Division and subsequently was granted the appropriate registration under Article 9 of the Law.

**Conclusion**

The investment businesses assessed dealt with the Commission in an open and co-operative manner throughout the examination process. The Commission was encouraged that the recommendations made on methods by which businesses could improve and update their systems and controls were accepted and, in many cases, remedial action was taken to rectify deficiencies prior to the Commission issuing its final report.

There are certain areas where businesses should enhance their existing policies and procedures, in particular, corporate governance, compliance monitoring and procedures covering the recruitment of new employees.

The Commission anticipates issuing the revised Investment Business Codes of Practice by the end of May 2008, and once issued, the intention is that these Codes will have a three-month transitional period.

The Commission's themed examination programme for 2008 will therefore focus on compliance with the revised Codes. This will involve a greater proportion of time being spent on examining the role and responsibilities of the compliance function, the registered person's financial resources and compliance with the Professional Indemnity Insurance requirements.

It is therefore important that investment businesses prepare for this by conducting a self-assessment against the revised Codes, if they have not done so already. The Investment Business team are happy to provide guidance in relation to the revised Codes and a link is provided, as follows;

http://www.jerseyfsc.org/pdf/Draft_Investment_Business_Codes_of_Practice_July_2007.pdf

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:

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