



# Jersey Financial Services Commission

## TRUST COMPANY BUSINESS

### ON-SITE EXAMINATION PROGRAMME 2008 SUMMARY FINDINGS

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#### **1 Introduction**

- 1.1 During 2008 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 relevant 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 firms 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 2008 using discovery, focused and themed techniques to review a broad spectrum of businesses. There were two types of themed examination undertaken, namely conduct of business and anti-money laundering/countering the financing of terrorism (“AML”).
- 2.2 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.
- 2.3 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 “**AML/CFT 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.

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

## **4 Overview**

- 4.1 A total of 53 on-site examinations were conducted during 2008, compared with 72 in 2007. Of this number, 12 comprised AML corporate governance themed examinations and 15 looked specifically at conduct of business, with the remaining 26 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:

<b>Action</b>	<b>2008 Number</b>	<b>2008 Percentage</b>	<b>2007 Percentage</b>
Enforcement action taken (for example directions issued or co-signatories appointed).	1	2%	3%
Follow up examination in those cases where examination findings were considered serious, to ensure Commission recommendations have been implemented.	3	6%	11%
Heightened supervision during the period of remediation, including regular meetings with management.	6	11%	*
Formal monitoring of implementation of corrective action plan, via Post Examination Monitoring Schedule.	22	41%	46%
No formal monitoring.	21	40%	40%
<b>Totals</b>	<b>53</b>	<b>100%</b>	<b>100%</b>

\* Statistic not available for 2007.

4.3 It can be seen that the cases where the Commission has to take enforcement action due to serious failings are few in number. In almost every case examined 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.

## 5 Findings

5.1 The observations detailed below have been drawn from on-site findings across all types of on-site examination conducted in 2008.

### General Corporate Governance

5.2 The Commission found deficiencies in corporate governance in approximately two thirds of the businesses examined in 2008. It is disappointing that this percentage has remained at a similar level for the last three years and as reported last year, there continues to be scope for improvement in this area.

- 5.3 There continues to be a failure by some businesses to document adequate terms of reference for committees established to manage specific areas of the business on behalf of the board of directors. The Commission would expect to see the following matters set out in a committee's terms of reference:
- 5.3.1 brief details outlining the committee's constitution;
  - 5.3.2 membership of the committee and attendance;
  - 5.3.3 frequency of meetings;
  - 5.3.4 authorities granted to the committee;
  - 5.3.5 specific duties of the committee; and
  - 5.3.6 manner and frequency of reporting to the board.
- 5.4 A number of other issues were noted by the Commission in this area, including the failure of boards to meet on a sufficiently regular basis, inadequate reporting to the board by the Compliance Officer, and occasional failure to prepare or approve minutes.
- 5.5 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.

### **The Compliance Function**

- 5.6 The Commission places considerable reliance on a business having a robust and effective compliance function. Whilst in the majority of cases the compliance function appears to be operating effectively, the Commission found that there is scope for improvement in the areas of compliance monitoring and reporting to the board.
- 5.7 It was found that in eight cases, the compliance monitoring programme was either non-existent, inadequately drawn up or not documented. In two cases, the Commission found that the business had an inadequate process for recording breaches of its own procedures, the Law, Orders and Codes of Practice. The Commission would consider that the maintenance of a breaches register would be one method by which this could be achieved, enabling a business to identify, record and remediate areas where there may be procedural problems and possible trends.
- 5.8 Where there was a compliance monitoring programme in place, there was inadequate reporting to the board in four instances.
- 5.9 There were a few instances where it was found that the Compliance Officer was undertaking too many roles, leading to an inability to carry out all of the allocated roles effectively. Whilst it is common in small businesses for one person to assume a number of different roles, firms should monitor whether an individual's workload is excessive, to prevent the above mentioned situation from arising.

## Risk Rating System

5.10 The Commission would like to draw to businesses' attention some of the more common findings in this area:

5.10.1 Trigger events – while most businesses have built into their procedures the requirement to risk rate a customer both at take on, and on a regular cycle (e.g. at periodic review) thereafter, a proportion of firms have failed to take trigger events into account. The Commission would recommend that firms consider which events would comprise a trigger to reassess the risk rating, and build these into their procedures. Examples of trigger events used by firms examined include:

5.10.1.1 change of beneficial owner or beneficiary;

5.10.1.2 change of country of residence of beneficial owner;

5.10.1.3 change in a customer's activity, source of wealth or occupation;

5.10.1.4 customer becoming a Politically Exposed Person (“PEP”);

5.10.1.5 issuance of a Suspicious Activity Report;

5.10.1.6 unexplained change in an entity's activity, or unusual transactions; and

5.10.1.7 change of purpose of a structure under administration.

5.10.2 Risk factors – some scoring systems apply inappropriate weightings to certain risk factors. For example, the scores applied to PEPs and registered office only business were insufficient to automatically elevate the customer to high risk.

5.10.3 Questions inappropriate or answered inadequately – in one case, the risk rating system was configured in such a way that the person completing the questionnaire had the option to answer questions relating to customers' source of wealth and source of funds as “impossible to determine”. The Commission has also seen examples of questions being answered inadequately, such that the true nature of the customer's activities was not adequately captured, thus resulting in an inappropriately low risk rating.

5.10.4 All businesses should be aware that a customer who is a PEP must attract a high risk rating as a result of Article 15 of the Money Laundering (Jersey) Order 2008 (the “MLO”). However, the Commission encountered one business where, while a PEP customer was risk rated high, there were underlying entities in the customer's structure which were risk rated low, as the directors considered the nature of the activity undertaken by the underlying entities was lower than high risk. In order for a registered person to adequately address the risk arising from any relationship with a PEP, and as required by Article 15 of the MLO, all entities associated with the PEP should be rated high risk and thus reviewed on a frequent basis. It is, however, for the registered person to determine the scope of that review.

### **Periodic Reviews**

- 5.11 The Commission was pleased to note a reduced incidence of backlogs in the preparation of periodic reviews this year. However, in 25% of businesses examined, it was found that the registered person had an inadequate system for dealing with the action points arising from periodic reviews, resulting in management being unable to quantify, prioritise and monitor clearance of outstanding matters.
- 5.12 The Commission considers it vital that businesses extend their procedures beyond the mere preparation of the periodic review, to incorporate a clear process for ensuring that action points are cleared in a timely manner, according to their priority. Progress in clearing action points should be monitored by senior management on a regular basis.

### **Policies and Procedures**

- 5.13 A common finding was a lack of control over the process for updating and amending procedures manuals. In order to demonstrate compliance with section 3.7 of the Codes of Practice for Trust Company Business, registered persons should be able to evidence the approval process for changes to procedures.
- 5.14 The Commission would expect approval to be given by the board or management committee for more significant amendments to procedures, while minor changes could perhaps be approved by the Compliance Officer.

### **Customer Due Diligence ("CDD")**

- 5.15 The Commission noted an improvement in the identity documentation held by businesses, but found CDD deficiencies in approximately 25% of businesses examined. The most common finding was inadequate documentation of information on source of funds and source of wealth. Understanding the source of funds, and in higher risk relationships, the customer's source of wealth, is an important aspect of CDD and the Commission places significant weight on the need for this to be adequately documented.

## **6 Findings arising from AML corporate governance themed examinations**

- 6.1 The Commission will be continuing the AML corporate governance themed examinations into 2009. A full summary of the findings of the AML examinations conducted in both 2008 and 2009 will be published early in 2010, but in the meantime a short summary of the issues arising from the AML examinations carried out in 2008 is set out below.

### **Business Risk Assessment and Strategy**

- 6.2 The Commission found that most businesses had given a great deal of thought to their business risk assessment and strategy. However, some businesses were more advanced in the development of their risk assessment and strategy than others.

- 6.3 In four of the businesses examined the risk assessment was in draft form and had not been approved by the board of directors, and in one case a risk assessment had not been prepared at all. Where a risk assessment did exist, it was found in around 50% of cases that the risk assessment required more detail to be provided in respect of the risks facing the business.
- 6.4 In three cases no business risk strategy had been prepared, and in a similar number of cases there was no link between the risk assessment and the strategy. The AML/CFT Handbook requires the strategy to be based upon the risk assessment. Furthermore, the strategy should be supported by appropriate policies and procedures, and there should be a clear connection between the risk assessment, the strategy and the policies and procedures.
- 6.5 In a number of cases, businesses had combined the risk assessment and strategy into one document. This proved to be an effective way of demonstrating the connection between the risk assessment and the strategy.

#### **Procedures**

- 6.6 In all businesses examined, it was found that the policies and procedures required updating to include certain requirements of the MLO and the AML/CFT Handbook, most notably in the area of corporate governance.

#### **Customer Profiling and Transaction Monitoring**

- 6.7 Around 50% of the businesses examined in 2008 did not have formal procedures in place to monitor transactions, and in four cases there was no question on the periodic review form to prompt a review of transactions undertaken during the period, i.e. retrospective monitoring against the customer profile. Whilst retrospective monitoring cannot prevent money laundering, the opportunity to review transactions during the periodic review process forms a useful addition to a business's defences against money laundering and is encouraged by the Commission.
- 6.8 Clearly, transaction monitoring can only be effective where detailed customer profiles have been prepared. Whilst all but three businesses examined had prepared customer profiles, in four cases it was found that the profiles were not detailed enough and in particular did not include sufficient information relating to the value and volume of expected transaction types.

#### **AML Training**

- 6.9 It is a requirement of Article 11(11) of the MLO that the effectiveness of AML training is assessed. In more than half the businesses examined, this requirement has not been specifically addressed. Businesses will need to consider and record the manner by which effectiveness of AML training will be assessed.

## **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 The Commission's risk based cycle of on-site examinations means that some businesses have now been examined on more than one occasion. The Commission has been pleased to note some marked improvements in most firms where examinations have been carried out for a second or third time. The Commission has been pleased to see businesses that are prepared to apply the appropriate resources in developing their systems and controls, including training of directors and staff, and where the compliance function is considered an integral part of the business.
- 7.3 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.
- 7.4 The implementation of the new AML/CFT Handbook and MLO has affected all businesses, although some have implemented the necessary changes more effectively than others. As noted above, the Commission will be continuing with AML corporate governance themed examinations during 2009.
- 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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