

STATES OF JERSEY



SUNSTONE HOLDINGS LTD. AND DE LEC LTD. – *EX GRATIA* PAYMENTS TO INVESTORS (P.90/2013) – COMMENTS

**Presented to the States on 23rd September 2013
by the Council of Ministers**

STATES GREFFE

COMMENTS

1. Senator Breckon has linked his proposal that an *ex gratia* payment be made to investors who suffered financial losses as a result of investments made in the companies named, to the precedent set by payments made to those who invested in Alternate Insurance Services Limited. Reference has been made to the Alternate Judgment and to the statements made by the Judge, including that '*for investors such as those to be left without compensation would not redound to the good reputation of Jersey and its investment community*'.
2. The circumstances of Alternate were different from those of the current proposal. It was also made clear at the time that the decision to give some compensation to the Alternate investors, many of whom were faced with great personal hardship, was not to be seen as a precedent. An important difference between Alternate and the current proposal is that Alternate was within the regulatory envelope of the Jersey Financial Services Commission (JFSC) and the latter had sought to recover funds from the investment advisers through the Court. The property investments to which the current proposal relates were not within the regulatory envelope.
3. In the Alternate case, the problem was created by licensed Independent Financial Advisers (IFAs) selling wholly inappropriate geared products within its own terms of business to unsophisticated investors. Many of the unsophisticated investors had a modest, or in one case no, income. Some investors were left servicing the debt they had incurred, to purchase the investment which was designed for high net worth and sophisticated investors that could afford to lose all or part of their investment. The JFSC plainly had responsibility for ensuring that the IFAs acted in a fit and proper manner and acted appropriately. It obtained a restitution order from the Court against Alternate and its principals (both of which were also prevented from working in the industry after the restitution order was obtained). Alternate was placed into liquidation and the business was closed. It sought to enforce the order (including forcing a repayment plan upon one of the principals, albeit for modest sums. It targeted third parties who had lent to and insured the scheme and recovered amounts which were distributed to the investors. All available avenues of recovery were pursued by the JFSC and exhausted. A shortfall was left and at that point – on hardship grounds – the States decided to compensate. The Court examined each investor's financial circumstances in detail and the full judgment, that is not publicly available, set out the hardship for each investor.
4. It has been suggested in correspondence sent to States members that the fraud was investigated belatedly by the JFSC. It acted immediately upon notice on 22nd January 2008 (in the form of a petition for a Court Order being published seeking redress for one of the investors) that there was a problem. It had received no prior notice of or complaint about these activities, nor could it have picked them up from its supervision of Goldridge Stone because they were being conducted separately from that entity on other contractual terms. On 1st February 2008, the Commission exercised its regulatory powers to demand documents and explanations from the principal persons. The Commission devoted considerable resource to undertaking what was a complex investigation but, by 27th June 2013, Goldridge Stone had been

closed and their licence revoked. All three principal persons were subsequently banned from employment in the finance industry by July 2013.

5. The point has been made by some of the investors that they were persuaded to invest in the US property development schemes because the persons marketing the scheme had been approved by the JFSC as 'fit and proper', albeit for different purposes. In the light of the Alternate case and other events, the JFSC has sought to educate investors of the risks associated with different types of investment under the heading of 'Protect Your Money'. The 'protect your money' website provides the following advice "*Do consider what balance of risk and return you are comfortable with. Remember the relationship between risk and reward. There is no such thing as a high return, risk-free investment*".
6. It is made clear by all regulatory authorities that when an investment is contemplated, particularly in high-risk areas such as off-plan foreign property purchases, investors should always seek independent advice separate from those promoting the investment scheme.
7. The proposition refers to an investor compensation scheme, the case for which remains outstanding. There are issues faced which need to be addressed: such as whether such a scheme could be limited to local residents or, if available to non-residents, whether it could be afforded. For example, the JFSC is currently seized of some substantial cases where UK-based retail investors have lost significant sums in overseas property development schemes where a regulated Jersey business has had some involvement.
8. What is clear, however, is that such a scheme would be a government responsibility and not a responsibility of the regulator, in the same way that such a distinction is drawn for depositor compensation. Indeed, Article 27 of the Financial Services (Jersey) Law 1998 explicitly makes this responsibility one for the States. An issue that this raises is how such a scheme would be funded. If the burden of funding was to be borne by investment advisers, this would present real problems for many of the smaller firms, and could force them out of business in the absence of similar schemes in competitive jurisdictions – the costs incurred could be expected to lead to business migrating to those jurisdictions.
9. Another point that has been raised is whether, if the investors had been in the UK, they would have been able to benefit from the UK investor protection scheme. Had the circumstances of this matter been encountered in the UK, it is extremely unlikely that a claim under the UK scheme would have been upheld, because the first test is that the "investment" must have been sold to the individual by an Authorised Firm. This is defined as "a company, unincorporated body, or individual permitted to carry out a regulated activity by the UK regulatory authorities".
10. The proposition calls for the funding of the compensation to come from the JFSC's funds. Reference has been made in the past to the JFSC's reserves as a source of funds for compensation but, putting aside that there is no statutory provision that would allow those funds to be accessed, it has been shown that these reserves are held to ensure that if the Commission has to take regulatory action through the Courts, it is never in a position where such action could not

be pursued through a lack of funds. Such a position, if it was to be faced, would be particularly detrimental to the Island's reputation as an international finance centre. In the Alternate case where the States decided to compensate and where the Commission clearly had statutory duties to exercise (which it had discharged to the best of its ability), there was no suggestion of the States payment being recovered from the Commission's reserves. It seems entirely unreasonable therefore that in this case, where the Commission has no statutory responsibility, that this is being asserted as a course of action.

11. It is recommended that any decision on whether the taxpayer should compensate the investors should depend on whether the circumstances of the case can be seen as sufficiently exceptional in terms of the hardship suffered, to gain widespread public support for any such action. In the light of the points made in this comment, and in particular the unknown cost that might flow from the precedent that would be set of which other investors, both resident and non-resident, could well seek to take advantage, it is not considered that the exceptional nature of this case has been sufficiently made for the proposition to be supported. The Council of Ministers therefore asks Members to reject the proposition.